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THE IMPACT OF AMENDMENTS TO SMALL BUSINESS PROCUREMENT PROGRAMS IN THE FISCAL YEAR 1987 DOD AUTHORIZATION ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT CONTRACTING
AND PAPERWORK REDUCTION

OF THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

THE IMPACT OF AMENDMENTS TO SMALL BUSINESS PROCUREMENT
PROGRAMS IN THE FISCAL YEAR 1987 DOD AUTHORIZATION ACT

SEPTEMBER 21, 1987

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HEARING DATE

September 21, 1987:
  Morning session 1

THE IMPACT OF AMENDMENTS TO SMALL BUSINESS PROCUREMENT PROGRAMS IN THE FISCAL YEAR 1987 DOD AUTHORIZATION ACT

MONDAY, SEPTEMBER 21, 1987

U.S. SENATE,
SUBCOMMITTEE ON GOVERNMENT CONTRACTING
AND PAPERWORK REDUCTION,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:33 a.m., in room 428A, Russell Senate Office Building, Hon. Alan Dixon (Chairman of the Subcommittee) presiding.

STATEMENT OF HON. ALAN J. DIXON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Senator DIXON. Good morning, ladies and gentlemen.

The Subcommittee on Government Contracting and Paperwork Reduction of the Committee on Small Business of the U.S. Senate will come to order.

This morning, the Subcommittee on Government Contracting and Paperwork Reduction will receive testimony on the likely impact of a series of amendments to the Small Business Act, which were included in section 921 of P.L. 99-661, the Department of Defense Authorization Act for fiscal year 1987.

These amendments were intended to make substantial changes in the conduct of the so-called "Small Business Set-Aside Program," in which certain contract opportunities are restricted for exclusive competition among eligible small business concerns.

These amendments to the Small Business Act were incorporated into the House version of the bill, H.R. 4428, during full Committee markup by the Chairman of the House Armed Services Committee, Representative Les Aspin, with the strong support of Parren J. Mitchell, then Chairman of the House Small Business Committee.

There was no opportunity for any hearings on the provisions by either the House Armed Services Committee or the House Small Business Committee.

The Senate version of the fiscal year 1987 DOD authorization bill did not contain any comparable provisions.

Unfortunately, the Senate Small Business Committee's request to appoint conferees was not favorably considered. Thus, this Committee had no direct role in shaping the amendments to the Small Business Act made by section 921.

Working closely with my good friend from Michigan, Senator Carl Levin, who serves with me on both this Committee and the Armed Services Committee, strong efforts were made to protect the interests of small business Government contractors. When it became clear that the House would not agree to delete the provisions, we sought to create the opportunity for careful analysis by the small business community, the Small Business Administration, the procuring agencies, and this Committee. To this end, the effective date for section 921 was delayed until October 1 of this year. A provision was added which required SBA to submit a report by July 15 of this year on the "advisability and feasibility of implementing" the substantial changes to the Small Business Set-Aside Program.

The SBA was specifically charged with seeking broad participation in its evaluative process.

This Committee also sought comment on the provisions.

In December 1986, Senators Bumpers, Weicker, and I sent letters soliciting comments from a broad array of business interests, encompassing large business as well as small business, and from the major procuring agencies.

Based on these responses, I began crafting the bill that has become S. 1559.

Basically, the bill is aimed at the severe implementational problems noted by the procuring agencies and the adverse effects on small business participation in the Federal market being predicted with regard to other provisions of Section 921.

I know that there are many sides to these issues and positions are strongly held regarding both the benefits and the problems predicted to flow from these changes to the Small Business Set-Aside Program. That is the purpose of these hearings: to receive and evaluate the various viewpoints.

Now, let me say that I have carefully read and analyzed the statements of all the witnesses. To the extent that those statements can be summarized so that we can have a useful question and answer period, it would be appreciated very much.

Our first witness is Monika Edwards Harrison, the Associate Administrator for Procurement Assistance of the SBA.

We welcome you, Ms. Harrison. Thank you for coming this morning.

STATEMENT OF MONIKA EDWARDS HARRISON, ASSOCIATE ADMINISTRATOR FOR PROCUREMENT ASSISTANCE, U.S. SMALL BUSINESS ADMINISTRATION

Ms. **Harrison**. Good morning, Mr. Chairman.

I am pleased to be able to offer testimony today on the report which we recently provided to the Congress regarding amendments to the Small Business Act by P.L. 99-591 and P.L. 99-661.

Pursuant to the requirement of these laws, SBA undertook a review of size standards in four mandated industry groups. These were construction, architect and engineering services, shipbuilding and ship repair, and refuse systems and services. In addition, we conducted a more extensive consideration of other amendments to the Small Business Act simultaneously.

The principal amendments of P.L. 99-661 expected to have an impact on the Small Business Administration Program are:

Small business set-asides and 8(a) contracts are not to be awarded at a price above the fair market price;

Eligibility for small business set-asides or 8(a) contracts will include agreement to perform at least 50 percent of the cost of a contract for services with the recipient's own employees, 50 percent of non-material costs in the case of manufacturing, and an amount to be determined by SBA in contracts for construction or in industries not otherwise covered;

The annual small and small disadvantaged business goaling by each procuring agency will include all awards, not only those above $10,000;

The policy calling for a fair proportion of Government contracts for small business is now directed at each SIC code industry, not at the total of Government procurements;

Size standards for small business will, by law, be set for each standard industrial classification code;

Contracting officers will be required, upon request, to provide a list of expected small business offerors when a small business set-aside is made;

A review of small business set-asides and 8(a) awards in the industries of construction, architecture-engineering services, shipbuilding and repair, and refuse systems and services is required, to determine whether or not these awards exceeded 30 percent of the value of awards in those respective industries during fiscal years 1984 through 1986. If so, the size standards are to be adjusted so that approximately 30 percent of those dollars awarded are set-asides or 8(a) contracts.

Among the activities which we undertook to respond to these requirements, we conducted surveys of Government personnel in a variety of agencies; we analyzed data from the Federal Procurement Data Center and correlated it with data from our own USEEM file; we interviewed procurement policy personnel at several major procuring agencies; we conducted a structured interview survey; we held discussions with representatives of industry associations; and we solicited and reviewed public comment by publication in both the "Federal Register" and the "Commerce Business Daily," as well as individual mailings to the numerous trade associations interested in these issues.

Following all of that, we developed and evaluated five alternative methodologies for performing the required size standard adjustment.

Following this analysis, we determined that 26 of the 29 SICs in the named industries exceeded the 30 percent target and would, consequently, require adjustment. Twenty-five of these SICs relate to construction; the 26th is land surveying services.

Shipbuilding and ship repair and refuse systems are not affected, since the 30 percent threshold was not reached.

We have provided exhibits which would show the impact of the changes we are proposing. We have proceeded ahead to the next stage, which is a notice of proposed rulemaking, although that has not yet appeared in the "Federal Register." As we indicate in our report, we believe that the Congress, following all of these discussions, may wish to consider other options for controlling the level of set-aside and 8(a) awards.

Among the other conclusions of our report were the following:

That the requirements for fair market price for award of set-aside and 8(a) contracts should be considered satisfied by the current standards of FAR for "fair and reasonable price;"

Second, that the requirement for a contractor's in-house performance of 50 percent of the labor costs of set-aside or 8(a) contracts is feasible; but administration of the rule would be simpler with a standard based on total contract value, rather than on the concept of costs.

Since SBA has already established the SIC system as the reference point for establishment of size standards, we have no objection to the statutory provision on this.

The additional burden on contracting officers to provide lists of prospective offerors we believe will be excessive in terms of the benefits.

Finally, we believe that our analysis of the 30 percent rule in the four industry groups will show that the imposition of the policy is a matter for further congressional consideration.

We are carrying out the mandate, as indicated in our report, but would point out that the impact on the affected SICs will be drastic. There will, no doubt, also be other effects on such things as small business statistics, ease of entry into the Federal marketplace in those industries, and on the current DOD goal of awarding 5 percent of its contract dollars to minority firms.

Therefore, we hope the Congress will explore more extensively the ramifications of the policy of correlating size and set-aside values.

On July 28, Senators Dixon, Weicker, and Bumpers introduced S. 1559. The bill addresses many of the recommendations we have made in volume I of our report. We concur with the provisions contained in S. 1559.

We believe they will make possible a more practical implementation of some of the concepts included in Section 921.

Nonetheless, with regard to section 4(a)(3) of S. 1559, we would point out that, by reinstating the fair proportion of Government contracts standard, in lieu of the industry categories, we fear that some contracting agencies may not move as expeditiously as possible to expand small business set-aside contracts in all agencies, but will, instead, continue to focus on only a few select industry categories.

That completes my formal remarks. I would be happy to answer any questions.

[The prepared statement of Ms. Harrison follows:]

SBA U.S. Small Business Administration Washington, DC 20416

TESTIMONY OF
MONIKA EDWARDS HARRISON
ASSOCIATE ADMINISTRATOR FOR PROCUREMENT ASSISTANCE,
SMALL BUSINESS ADMINISTRATION
BEFORE THE
SUBCOMMITTEE ON GOVERNMENT CONTRACTING AND PAPERWORK REDUCTION,
COMMITTEE ON SMALL BUSINESS,
UNITED STATES SENATE
SEPTEMBER 21, 1987

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE: I AM MONIKA EDWARDS HARRISON, ASSOCIATE ADMINISTRATOR FOR PROCUREMENT ASSISTANCE OF THE SMALL BUSINESS ADMINISTRATION (SBA). I AM PLEASED TO BE ABLE TO OFFER TESTIMONY TODAY ON THE REPORT PROVIDED TO THE CONGRESS BY SBA ON JULY 14TH, REGARDING THE AMENDMENTS TO THE SMALL BUSINESS ACT BY PUBLIC LAWS 99-591 AND 99-661, AND ENTITLED "ADVISABILITY AND FEASIBILITY OF IMPLEMENTING SECTION 921 OF PUBLIC LAWS 99-591 AND 99-661."

PURSUANT TO REQUIREMENT OF THESE LAWS, SBA UNDERTOOK A REVIEW OF SIZE STANDARDS IN FOUR MANDATED INDUSTRY GROUPS (CONSTRUCTION; ARCHITECT AND ENGINEERING SERVICES; SHIP BUILDING AND SHIP REPAIR; AND REFUSE SYSTEMS AND SERVICES) AND, A MORE EXTENSIVE CONSIDERATION OF OTHER AMENDMENTS TO THE SMALL BUSINESS ACT.

THE PRINCIPAL AMENDMENTS OF P.L. 99-661 EXPECTED TO HAVE AN IMPACT ON THE SMALL BUSINESS ADMINISTRATION PROGRAM ARE:

o SMALL BUSINESS SET-ASIDES AND "8(a)" CONTRACTS ARE NOT TO BE AWARDED AT A PRICE ABOVE THE "FAIR MARKET PRICE".

o ELIGIBILITY FOR SMALL BUSINESS SET-ASIDES OR "8(a)" CONTRACTS WILL INCLUDE AGREEMENT TO PERFORM AT LEAST 50 PERCENT OF THE COST OF A CONTRACT FOR SERVICES WITH THE RECIPIENT'S OWN EMPLOYEES; 50 PERCENT OF NON-MATERIAL COSTS IN THE CASE OF MANUFACTURING; AND, AN AMOUNT TO BE DETERMINED BY SBA IN CONTRACTS FOR CONSTRUCTION, OR IN INDUSTRIES NOT OTHERWISE COVERED.

o THE ANNUAL SMALL AND SMALL DISADVANTAGED BUSINESS GOALING BY EACH PROCURING AGENCY, ESTABLISHED UNDER SECTION 15(g) OF THE SMALL BUSINESS ACT, WILL INCLUDE ALL AWARDS, NOT ONLY THOSE ABOVE $10,000.

o THE POLICY CALLING FOR A FAIR PROPORTION OF GOVERNMENT CONTRACTS FOR SMALL BUSINESS IS NOW DIRECTED AT EACH STANDARD INDUSTRIAL CLASSIFICATION (SIC) CODE INDUSTRY, NOT AT THE TOTAL OF GOVERNMENT PROCUREMENTS.

o SIZE STANDARDS FOR SMALL BUSINESS WILL, BY LAW, BE SET FOR EACH STANDARD INDUSTRIAL CLASSIFICATION CODE.

o CONTRACTING OFFICERS WILL BE REQUIRED, UPON REQUEST, TO PROVIDE A LIST OF EXPECTED SMALL BUSINESS OFFERORS WHEN A SMALL BUSINESS SET-ASIDE IS MADE.

o A REVIEW OF SMALL BUSINESS SET-ASIDES AND 8(a) AWARDS IN THE INDUSTRIES OF CONSTRUCTION, ARCHITECT-ENGINEERING SERVICES, SHIP BUILDING AND REPAIR, AND REFUSE SYSTEMS AND SERVICES IS REQUIRED, TO DETERMINE WHETHER THESE AWARDS EXCEEDED 30% OF THE VALUE OF AWARDS IN THE RESPECTIVE INDUSTRIES DURING FYs 1984-1986. IF SO, THE SIZE STANDARDS ARE TO BE ADJUSTED SO THAT APPROXIMATELY 30% OF THE DOLLARS AWARDED ARE SET-ASIDES OR 8(a) CONTRACTS.

IN ORDER TO RESPOND TO THESE REQUIREMENTS SBA:

- CONDUCTED SEVERAL SURVEYS OF GOVERNMENT PERSONNEL IN A VARIETY OF FEDERAL AGENCIES.
- ANALYZED DATA FROM THE FEDERAL PROCUREMENT DATA CENTER (FPDC) AND CORRELATED IT WITH DATA FROM THE UNITED STATES ESTABLISHMENT AND ENTERPRISE MICRODATA (USEEM) FILE.
- INTERVIEWED PROCUREMENT POLICY PERSONNEL OF SEVERAL MAJOR PROCURING AGENCIES.
- CONDUCTED A STRUCTURED INTERVIEW SURVEY WITH KNOWLEDGEABLE PERSONS, ORIENTED TO THE FIELD OF ECONOMICS.
- HELD DISCUSSIONS WITH REPRESENTATIVES OF INDUSTRY ASSOCIATIONS.
- SOLICITED AND REVIEWED PUBLIC COMMENT BY PUBLICATION IN THE FEDERAL REGISTER AND THE COMMERCE BUSINESS DAILY AS WELL AS BY MAILINGS TO NUMEROUS TRADE ASSOCIATIONS.
- DEVELOPED AND EVALUATED FIVE ALTERNATIVE METHODOLOGIES FOR PERFORMING THE REQUIRED SIZE STANDARD ADJUSTMENT.

FOLLOWING OUR ANALYSIS OF THE "30% RULE" IN THE FOUR AFFECTED INDUSTRY GROUPS, WE DETERMINED THAT TWENTY-SIX OF THE TWENTY-NINE SICs IN THE NAMED INDUSTRIES EXCEEDED THE 30% TARGET AND WOULD REQUIRE ADJUSTMENT OF SIZE STANDARD. TWENTY-FIVE OF THESE SICs RELATE TO CONSTRUCTION; THE TWENTY-SIXTH IS LAND SURVEYING SERVICES. SHIP BUILDING AND SHIP REPAIR, AND REFUSE SYSTEMS ARE NOT AFFECTED SINCE THE 30% THRESHOLD WAS NOT REACHED. THE PROSPECTIVE CHANGES, BASED ON THE PROCEDURE WE SELECTED FROM OUR ALTERNATIVES, ARE PROVIDED AS EXHIBIT A. WE ARE PROCEEDING WITH IMPLEMENTATION, HAVING RECENTLY PREPARED A NOTICE OF PROPOSED RULEMAKING TO EFFECT THE REDUCTIONS IN AFFECTED INDUSTRIES. ALTHOUGH, AS WE INDICATE IN OUR REPORT, WE BELIEVE THAT CONGRESS MAY WISH TO CONSIDER OTHER OPTIONS FOR CONTROLLING THE LEVEL OF SET-ASIDE AND 8(a) AWARDS.

REGARDING THE OTHER AREAS OF THE REPORT, SOME OF OUR CONCLUSIONS WERE:

- REQUIREMENTS FOR "FAIR MARKET PRICE" FOR AWARD OF SET-ASIDE AND 8(a) CONTRACTS SHOULD BE CONSIDERED SATISFIED BY THE STANDARDS OF THE FEDERAL ACQUISITION REGULATION FOR "FAIR AND REASONABLE PRICE."

- THE REQUIREMENT FOR CONTRACTOR'S IN-HOUSE PERFORMANCE OF 50% OF THE LABOR COSTS OF SET-ASIDE OR 8(a) CONTRACTS IS FEASIBLE, BUT ADMINISTRATION OF THE RULE WOULD BE SIMPLER WITH A STANDARD BASED ON TOTAL CONTRACT VALUE, RATHER THAN "COSTS."

- SINCE SBA HAS ALREADY ESTABLISHED THE SIC SYSTEM AS THE REFERENCE POINT FOR ESTABLISHMENT OF SIZE STANDARDS, WE HAVE NO OBJECTION TO THE STATUTORY PROVISION ON THIS. WE DO BELIEVE, HOWEVER, THAT FLEXIBILITY TO REACT TO INDUSTRIES WHICH DO NOT FIT THE SIC STRUCTURE MAY BE IMPAIRED BY SUCH A REQUIREMENT.

- THE ADDITIONAL BURDEN ON CONTRACTING OFFICERS TO PROVIDE LISTS OF PROSPECTIVE OFFERORS ON SET-ASIDES WILL, WE BELIEVE, BE EXCESSIVE IN TERMS OF ANY POSSIBLE BENEFITS.

- FINALLY, WE BELIEVE OUR ANALYSIS OF THE "30% RULE" IN THE FOUR INDUSTRY GROUPS SEPCIFIED IN PUBLIC LAWS 99-591 AND 99-661 WILL SHOW THAT THE IMPOSITION OF THE POLICY IS A MATTER FOR FURTHER CONGRESSIONAL CONSIDERATION. WE ARE CARRYING OUT THE MANDATE, AS INDICATED IN OUR REPORT, BUT WOULD POINT OUT THAT THE IMPACT ON THE AFFECTED SICs WILL BE DRASTIC. THERE WILL, NO DOUBT, ALSO BE OTHER EFFECTS ON SMALL BUSINESS STATISTICS, ON EASE OF ENTRY INTO THE FEDERAL MARKETPLACE IN THOSE INDUSTRIES, AND ON THE CURRENT DOD GOAL OF AWARDING 5% OF ITS CONTRACT DOLLARS TO MINORITY FIRMS. THEREFORE, WE HOPE THE CONGRESS WILL EXPLORE MORE EXTENSIVELY THE RAMIFICATIONS OF THE POLICY OF CORRELATING SIZE AND SET-ASIDES VALUES, BEFORE APPLYING IT MORE BROADLY. THIS HEARING WILL AFFORD YOU AN OPPORTUNITY TO HEAR FROM MANY OF THE GROUPS AND FEDERAL AGENCIES WHICH HAVE ALREADY WRITTEN TO US AND WE ARE GLAD TO BE A PART OF YOUR DELIBERATIONS ON THIS IMPORTANT MATTER.

ON JULY 28, 1987, SENATORS DIXON, WEICKER AND BUMPERS INTRODUCED S.1559, TO AMEND THE SMALL BUSINESS ACT TO MODIFY CERTAIN PROVISIONS RELATING TO THE SMALL BUSINESS SET-ASIDE PROGRAM. THE BILL ADDRESSES MANY OF THE RECOMMENDATIONS WE HAVE MADE IN VOLUME I OF OUR REPORT ENTITLED "ADVISABILITY AND FEASIBILITY OF IMPLEMENTING SECTION 921 OF PUBLIC LAWS 99-591 and 99-661." WE CONCUR WITH THE PROVISIONS CONTAINED IN S.1559 AND BELIEVE THEY WILL MAKE POSSIBLE A MORE PRACTICAL IMPLEMENTATION OF SOME OF THE CONCEPTS INCLUDED IN SECTION 921(c) OF PUBLIC LAW 99-661. NONETHELESS, WITH REGARD TO SECTION 4(a)(3) OF S.1559, WE WOULD POINT OUT THAT BY REINSTATING THE "FAIR PROPORTION OF GOVERNMENT CONTRACTS" STANDARD, IN LIEU OF THE "INDUSTRY CATEGORIES" STANDARD CONTAINED IN SECTION 921, SOME CONTRACTING AGENCIES MAY NOT MOVE AS EXPEDITIOUSLY AS POSSIBLE TO EXPAND SMALL BUSINESS SET-ASIDE CONTRACTS IN ALL INDUSTRIES, BUT WILL CONTINUE TO CONCENTRATE ON ONLY A FEW SELECT INDUSTRY CATEGORIES INSTEAD.

THIS COMPLETES MY PREPARED REMARKS, MR. CHAIRMAN. I WILL BE GLAD TO RESPOND TO ANY QUESTIONS THE COMMITTEE MAY HAVE.

EXHIBIT A

SIZE STANDARDS FROM RECOMMENDED PROCEDURE DESIGNED TO RESPOND TO PUB. L. 99-591
(M = millions of dollars)

SIC	CURRENT SIZE STANDARD	PROPOSED
1521	$17.0M	2.00M
1522	17.0M	9.75M
1531	17.0M	1.25M
1541	17.0M	5.25M
1542	17.0M	3.50M
1611	17.0M	4.00M
1622	17.0M	1.75M
1623	17.0M	1.25M
1711	7.0M	1.25M
1721	7.0M	.50M
1731	7.0M	1.50M
1741	7.0M	1.50M
1742	7.0M	.25M
1743	7.0M	1.25M
1751	7.0M	.75M
1752	7.0M	.75M
1761	7.0M	1.00M
1771	7.0M	.50M
1781	7.0M	.75M
1791	7.0M	4.50M
1793	7.0M	1.00M
1794	7.0M	.50M
1795	7.0M	3.75M
1796	7.0M	2.75M
1799	7.0M	2.50M
8711 Surveying)	2.5M	.25M

VOLUME I

ADVISABILITY AND FEASIBILITY
OF IMPLEMENTING
SECTION 921 of PUBLIC LAWS 99-591 and 99-661

Prepared for:

Committee on Armed Forces
and the Committee on Small Business
U. S. House of Representatives
Washington, D.C.

and

Committee on Armed Services
and the Committee on Small Business
U.S. Senate
Washington, D.C.

Prepared by:

U.S. Small Business Administration
Office of Procurement Assistance
Office of Procurement Policy and Liaison
Washington, D.C. 20416

July 14, 1987

EXECUTIVE SUMMARY

Public Laws 99-591 and 99-661 required SBA to conduct this study on the "advisability and feasibility" of implementing the amendments to the Small Business Act. To evaluate effectively the impact of the amendments on SBA programs, SBA conducted and carried out a number of research efforts: (1) an extensive review of related literature, (2) a structured interview survey, (3) several questionnaire surveys, (4) analysis of data from the Federal Procurement Data Center and the United States Establishment and Enterprise Microdata file, (5) interviews with procurement policy personnel of major agencies, (6) discussions with representatives of major industry associations and, (7) solicitation of public comment.

The principal amendments of P.L. 99-661 which must be implemented and that are expected to have an impact on the Small Business Administration programs are:

1. Neither small business set-asides nor "8(a)" contracts may be awarded above the "fair market price";

2. Recipients of small business set-asides or "8(a)" contracts for services must perform at least 50 percent of the cost of the contract with their own employees, 50 percent of non-material costs in the case of manufacturing, and an amount to be determined by SBA in the case of construction or any other industry not covered by the statute;

3. The annual goals of each procuring agency, established under section 15(g) of the Small Business Act, will be premised upon all awards, rather than upon those above $10,000;

4. The objective of achieving a fair proportion of Government contracts for small business is now directed at each Standard Industrial Classification (SIC) code industry, rather than at the totality of Government procurement, as previously held;

5. Size standards for small business eligibility will be based on SIC industries, by law;

6. Contracting officers will be required, upon request, to provide a list of expected small business offerors when a small business set-aside is made; and

7. Size standards in the industries of construction, architectural and engineering services, shipbuilding and repair, and refuse systems and related services are to be adjusted to assure that small business set-asides and "8(a)" contracts do not account for more than 30 percent of awards in each industry.

Fair Market Price

Legislative history indicates that the purpose of the statutory standard of "fair market price" was to provide a more precise definition of when a set-aside offer may be accepted.

Small business set-aside price reasonability is covered thoroughly in FAR 14.407-2 and 15.802 in the same manner as unrestricted procurement. Additionally, the full discussion of "fair market price" for 8(a) now in FAR approximates the referenced regulations for establishing a "reasonable" price.

SBA believes, therefore, that the references to "fair market price" should be considered synomynous with "reasonable price" and that the existing FAR standards for determining a "reasonable" price should be applied both to 8(a) and set-asides.

"50% Rule"

The "50% rule" limitation on subcontracting imposed by this new statutory provision on the set-aside program is intended to prevent system abuses, although the restriction may be detrimental to some small businesses, which often lack the in-house capabilities that large businesses have. From the study results, however, it would appear that the subcontracting limitation provision would not have an adverse effect on most of the reviewed industries.

While there was public comment on the "50% rule" as a result of the Federal Register announcement, no concrete data were presented which would justify modification of the rule. Additionally, preparation of a model and limited experiments with it supported the tentative view that the rule could be applied consistently. The principal problem with the rule is the administrative difficulty of enforcement. That difficulty would be eased by permitting the application of measurement to the value of the contract in question rather than to "costs" which are more subject to variable accounting methods.

Goaling

Since implementing goal-setting in 1980, there has been only a small increase in the annual share of federal contract dollars going to the four targeted groups examined. Although there has been a significant increase from FY 80 of 17 percent to 20 percent in FY 86, in the small business share (Table 4.2), the increase between years has been relatively small. Therefore, the data tends to support the public argument that goaling had only a small impact on increasing the small and small disadvantaged business share of the total federal contract budget.

Even a small impact, however, means a significant increase in the dollars going to small business. Additionally, the overall value of "goaling" as a means of focusing attention of procurement personnel on small business participation was supported by procurement policy personnel of some major agencies. SBA, therefore, supports the continued use of "goaling."

SBA believes that goaling enhances small and small disadvantaged business participation in Federal contracts. In order to make goaling meaningful in terms of the requirements, SBA propose a consistent structure for the agency attempts to expand participation by industry category.

SBA suggests that Federal Procurement Data Center (FPDC) data be obtained by agencies, establishing on a government-wide basis the level of participation by small and small disadvantaged business in each of the most significant SICs, i.e., those in which the major portions of dollar value are being awarded. SBA would identity these annually from FPDC data. Agencies would also obtain from FPDC a record for the major SICs. This will permit each agency to address a manageable span of issues by establishing the reasons for their variance and identifying means to enhance participation where it is possible.

"Fair Proportion" by SIC

The goal of a "fair proportion" for small business in each SIC is intended to increase the opportunities for small business to participate in a broader variety of procurements on an industry-by industry basis, rather than limiting their participation to a few industries where small business has historically received a large share.

On balance, SBA considers that goaling will focus attention on those SICs in which small and small disadvantaged business is now at minimal levels.

SIC System for Establishing Size Standards

Although there are many known defects in the SIC system, it still remains the most popular delineator of economic markets. SBA has used it in the past by administrative choice, and has no objection to continued use. However, some industries exist or come into being which do not fit the SIC structure, the flaws of which are noted in this report, SBA may be unable to deal directly with the problem because of the restriction by the law to the SIC system.

Listing of Candidate Firms for Set-Asides

While the increase of opportunity to identity violations of small business certification is a beneficent purpose, SBA believes that the increased burdens on contracting personnel would, on balance, detract from the use of set-asides, to the overall detriment of the general community of small businesses interested in Government business.

"30% Rule"

The amendments address two features of the set-aside and 8(a) programs—the level of set-asides and the definition of eligible small businesses. These features focus policy debate on questions of how much contract funding to devote to support these programs and who will be the potential beneficiaries of the programs.

The amendments attempt to answer the question of the level of contract funding by controlling who may participate in the programs. In the report, one of the weaknesses cited for the methods used to develop revised size standards was the uncertainty of the effectiveness of the lower standards to reduce the level of set-aside and 8(a) contracts. A more effective policy to lower set-asides and 8(a) contracts may be to set a cap on these awards on a Federal-wide or Agency-wide basis. It may also be a more efficient way to achieve lower set-asides and 8(a) contracts.

VOLUME II

ADVISABILITY AND FEASIBILITY
OF IMPLEMENTING
SECTION 921(f) of PUBLIC LAW 99-661

Prepared for:

Committee on Armed Forces
and the Committee on Small Business
U. S. House of Representatives
Washington, D.C.

and

Committee on Armed Services
and the Committee on Small Business
U.S. Senate
Washington, D.C.

Prepared by:

U.S. Small Business Administration
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July 14, 1987

EXECUTIVE SUMMARY

Public Laws 99-591 and 99-661 require a determination of whether the value of small business set-asides and 8(a) awards in FY 1984-86 together exceeds 30 percent of Federal procurement in the following industry groups: construction; engineering, including architecture and surveying; shipbuilding and ship repair; and refuse systems. The broad industry groups comprise 29 separate industries.

In industries where more than 30 percent of Federal procurements were set aside, SBA must propose new size standards which are likely to reduce the set-aside amount to no more than 30 percent. Also, the law permits, but does not require, the segmentation of size standards according to type of equipment used and region of the country. In explanatory remarks in the Congressional Record in October 1986 and in a letter to SBA in November 1986, the former House Small Business Committee Chairman, Parren Mitchell, urged segmentation for the dredging and shipbuilding and ship repair industries.

The report's initial finding is that the 30 percent set-aside level was exceeded in all construction industries except heavy construction, not elsewhere classified (N.E.C) and dredging (SIC Code 1629). The 30 percent level is also exceeded in land surveying services (SIC Code 8713). Thus there are 26 industries requiring size standard changes to be proposed. Table 1 shows the percentage of set-aside and 8(a) awards for the 29 industries involved in the study during FY 1984-86.

TABLE 1

SMALL BUSINESS SET-ASIDES AND 8(a) CONTRACT AWARDS AS A PERCENT OF ALL FEDERAL PROCUREMENTS, FY 1984—FY 1986 AVERAGE

STANDARD INDUSTRIAL CLASSIFICATION	INDUSTRY DESCRIPTION	PERCENT SET-ASIDE AND 8(a) AWARDS
1521	Single Family Housing Construction	45.3
1522	Residential Construction, N.E.C.*	39.0
1531	Operative Builders	45.7
1541	Industrial Builders and Warehouses	54.6
1542	Nonresidential Construction, N.E.C.	64.0
1611	Highway and Street Construction	53.3
1622	Bridge, Tunnel & Elevated Highway Construction	52.6
1623	Water, Sewer, and Utility Line Construction	71.1
1629	Heavy Construction, N.E.C.*:	
	All Except Dredging	20.9
	Dredging	16.6
1711	Plumbing, Heating, Air Conditioning	69.9
1721	Painting, Paper Hanging and Decorating	89.6
1731	Electrical Work	62.5
1741	Masonry and Other Stonework	68.9
1742	Plastering, Drywall and Insulation	67.7
1743	Terrazo, Tile, Marble, and Mosaic Work	78.7
1751	Carpentering	91.7
1752	Floor Laying and Floor Work, N.E.C.*	88.2
1761	Roofing and Sheet Metal Work	89.3
1771	Concrete Work	91.5

(cont.)

STANDARD INDUSTRIAL CLASSIFICATION	INDUSTRY DESCRIPTION	PERCENT SET-ASIDE AND 8(a) AWARDS
1781	Water Well Drilling	55.4
1791	Structural Steel Erection	45.9
1793	Glass and Glazing Work	89.8
1794	Excavating and Foundation Work	84.4
1795	Wrecking and Demolition Work	79.8
1796	Installing Building Equipment, N.E.C.*	52.6
1799	Special Trade Contractors, N.E.C.*	51.7
3731	Shipbuilding and Repairing	7.7
4953	Refuse Systems	22.4
8711-13	Engineering, Architectural and Surveying:	16.1
	Engineering For Military Equipment and Weapons	..... 14.2
	Engineering and Architecture Services, Not For Military Equipment and Weapons.............	..... 24.5
	Marine Engineering and Naval Architecture	..... 7.2
	Land Surveying Services	..... 74.0

* N.E.C. = Not Elsewhere Classified
SOURCE: Federal Procurement Data Center

The Agency has encouraged public participation in implementing the law. Notices appeared in the Federal Register and Commerce Business Daily in March 1987. Also, SBA issued a press release; notices were sent to 100 major industry trade organizations; and SBA personnel visited some major industry organizations to ensure wide public comment.

As of April 30, 1987, SBA received 72 comments from the March 1987 notice. Of 11 commenting on the segmentation issue for dredging, only 2 were in favor; for shipbuilding and ship repair of 9 commenting, 3 favored and 6 opposed segmentation. Eight firms commented as to whether a cut-off percentage of greater than 30 percent should be used; 6 were opposed to this. The appendix to the study has a complete description of the comments.

The report also explains in detail the data and methodologies used in devising the proposed size standards. The recommended method for setting new size standards compares the size of firms doing business in a particular Government market with the amount of set-aside or 8(a) contracts. At the point where the larger small firms have received contracts in excess of 30 percent, the size standard is set at that size of firm. The calculation of the proposed size standard for the single-family house construction industry, SIC-1521, illustrates the recommended method. For this industry there were $48.1 million in excess small business contracting. Table 2 shows the size of firm, ranked from large to small in employees, and the value of set-aside contracts awarded to the firm. Firms are ranked in terms of employees rather than sales because employee information is considered more reliable and timely than sales information. Column 5 calculates the cumulative value of set-aside contracts beginning with the largest firm. The standard is set at the firm size where cumulatively $48.1 million of contracts have been awarded to firms larger than that size. In the example, $48.1

TABLE 2

FIRMS RECEIVING SET-ASIDE AND/OR 8(a) CONTRACTS RANKED BY EMPLOYEE SIZE OF FIRMS (Dollar Amounts are in Thousands (1986 RECORDS))

SIC=1521—SINGLE FAMILY HOUSING CONSTRUCTION

(1) DUNS NO.	(2) FIRM EMPLOYMENT	(3) FIRM SALES ($000)	(4) 8(a)/Set-Aside CONTRACTS $(000)	(5) CUMULATIVE TOTAL ($000)
62301791	200	13,000	2,009	2,009
03874807	100	8,000	300	2,309
79365888	100	0	8,475	10,784
06843544	80	5,000	1,031	11,815
07009970	70	4,500	935	12,750
62208103	70	4,490	12	12,762
95480893	70	3,190	14	12,776
06825145	69	6,410	3,923	16,699
30083604	60	7,710	59	16,758
09799019	60	3,000	773	17,531
49132020	60	2,140	1,744	19,275
71830905	60	2,000	364	19,639
31636110	52	2,340	5,260	24,899
06843031	50	0	674	25,573
98707706	50	0	40	25,613
13529771	48	0	6,811	32,424
91705020	45	2,130	730	33,154
41312752	40	4,000	307	33,461
06842801	35	14,700	6,604	40,065
05812789	35	3,700	313	40,378
68403799	33	6,850	1,088	41,466
95831178	30	1,300	30	41,496
37364270	30	1,070	64	41,560
32285388	30	0	39	41,599
02496073	28	5,000	3,091	44,690
94602554	27	3,190	40	44,730
53398178	27	2,000	63	44,793
41352949	25	20,000	378	45,171
06845142	25	6,000	631	45,802
33385188	25	3,770	124	45,926
18619056	24	4,000	129	46,055
21238670	23	2,100	11	46,066
65115230	22	0	11	46,077
55723506	21	3,000	766	46,843
13159736	21	2,000	782	48,100*

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* Point of 30 percent cumulative contract award value.

TABLE 2 (Cont.)

SIC=1521—SINGLE FAMILY HOUSING CONSTRUCTION

DUNS NO.	FIRM EMPLOYMENT	FIRM SALES ($000)	8(a)/Set-Aside CONTRACTS $(000)	CUMULATIVE TOTAL ($000)
36002129	20	7,000	6,431	54,056
21871207	20	3,000	89	54,145
08795445	20	2,000	449	54,594
17406041	20	0	1,181	55,775
08695941	20	0	476	56,251
84800143	20	0	267	56,518
37149606	20	0	170	56,688
47600895	20	0	38	56,726
94344447	18	4,000	1,778	58,504
39366794	18	2,100	-1	58,503
91699215	17	1,200	365	58,868
85266039	17	1,000	328	59,196
29526811	16	2,500	15	59,211
48383897	16	2,080	724	59,935
48045041	15	7,000	224	60,159
89405245	15	4,000	4	60,163
99667891	15	2,000	177	60,340
61459103	15	1,950	56	60,396
69802478	15	1,850	889	61,285
02786820	15	1,000	77	61,362
41734583	15	882	54	61,416
03503992	15	779	542	61,958
62677695	15	400	83	62,041
07658890	15	292	295	62,336
97149439	15	0	50	62,386
22683303	14	6,240	326	62,712
65648925	14	3,550	1,103	63,815
56408883	14	3,260	166	63,981
04033510	14	0	277	64,258
17426510	13	2,500	158	64,416
19192375	13	378	539	64,955
21945928	12	3,000	1,269	66,224
04430997	12	2,340	69	66,293
84816404	12	1,140	107	66,400
48365654	12	880	33	66,433
95745006	12	792	591	67,024
62105275	12	650	11	67,035
03370103	12	550	33	67,068
48393655	12	0	126	67,194
01245827	12	0	123	67,317

million of set-asides were awarded to firms that had more than 21 employees. Firm size by employee number is converted to a dollar equivalent (based on average sales per employee in the industry) and results in a $2 million size standard.

The specific size standards resulting from this method range from $9.5 million for general construction of residential buildings (SIC-1522) to $0.25 million for surveying (SIC-8713), and plastering and drywall (SIC-1742), as shown in Table 3. On average, the proposed size standards are reduced by approximately 80 percent.

The estimated impact of the new size standards is that $2.3 billion will change from the set-aside or 8(a) category to the unrestricted category. This estimate is based on the 1984-86 average annual level of procurement. It represents the dollar value of the shift away from small business set-asides required to comply with P.L. 99-591.

A broader impact is the change in small business status of firms in those industries where the size standards would change. About 50,000 firms, which in 1984 accounted for about $134 billion in sales, would be moved from the small to the other-than-small category. Of course, for those firms not actively involved in Federal procurement and other SBA programs, there would be no immediate impact from a change in eligibility associated with lower size standards.

In addition to the method recommended above, the SBA also considered four alternative methods of setting size standards as follows:

1) Set size standards in response to recommendations offered by various procurement offices which were surveyed by SBA. This approach would rely on a selected group of individuals who are very knowlegeable of the set-aside program.

SIZE STANDARDS FROM RECOMMENDED PROCE E DESIGNED TO RESPOND TO PUB. L. 99-5
(M = millions of dollars)

SIC	CURRENT SIZE STANDARD	PROPOSED
1521	$17.0M	2.00M
1522	17.0M	9.75M
1531	17.0M	1.25M
1541	17.0M	5.25M
1542	17.0M	3.50M
1611	17.0M	4.00M
1622	17.0M	1.75M
1623	17.0M	1.25M
1711	7.0M	1.25M
1721	7.0M	.50M
1731	7.0M	1.50M
1741	7.0M	1.50M
1742	7.0M	.25M
1743	7.0M	1.25M
1751	7.0M	.75M
1752	7.0M	.75M
1761	7.0M	1.00M
1771	7.0M	.50M
1781	7.0M	.75M
1791	7.0M	4.50M
1793	7.0M	1.00M
1794	7.0M	.50M
1795	7.0M	3.75M
1796	7.0M	2.75M
1799	7.0M	2.50M
8711 Surveying)	2.5M	.25M

2) Set size standards to eliminate from eligibility any firm winning any one of the larger set-aside or 8(a) contracts in the industry under review. By eliminating such firms one could assume these larger contracts would be unrestricted, because the pool of competent firms capable of performing the formerly set-aside or 8(a) contracts would be sharply curtailed.

3) Set the size standard in each industry such that firms defined as small nationally would cumulatively generate 45 percent of all receipts in the industry under review. This approach would provide a standardized receipts share measure for small firms of 45 percent.

4) Lower the size standard in each industry under review such that firms losing eligibility generate in aggregate the percent of total industry sales which the laws require to be shifted to the unrestricted category. This approach also ignores Government procurement patterns. By eliminating firms from eligibility based on national industry distributions, it is felt that the proportion of contracts in the form of set-aside or 8(a) contracts would total 30 percent or less in each industry.

These approaches, while they have some advantages, and could be used in a highly controllable procurement environment, were rejected for a variety of reasons outlined in the report.

Senator DIXON. Thank you very much, Ms. Harrison, for your helpful analysis of the situation as it presently exists.

I thought I might ask you a number of questions pertaining to what we attempt to rectify in this bill. But the first observation I want to make is this. I note in your testimony and I think I will find in the testimony of most people here that there is probably more concern about the 30 percent rule than, really, about anything in the change that was made in the DOD authorization bill that we passed last year.

You will note that the bill that I have introduced, with the cosponsorship of the Chair and the Ranking Member, does not address that subject. Quite frankly, the reason it does not address that subject is that we did not think we had sufficient time, given the controversy involved in that area, to make that correction this year. We thought it was an area in need of substantial attention, and, quite frankly, I think it will be a follow-along that we will review. I suspect that most people in this room, and others around the country who are interested in this issue will very vociferously argue their point of view on this question. I just don't think we could get it done right now.

That is the reason that this is not part of the bill that we have introduced. It simply was thought that everything else would be obfuscated by the argument over that issue and we could not try to address some of the other things that might be more reasonably addressed.

If I could, I would go through those with you.

Ms. HARRISON. Certainly.

Senator DIXON. On the whole question of changing "fair and reasonable" to "fair market price," I note that you simply say that contracts should be considered satisfied by the standards of the Federal Acquisition Regulation for a fair and reasonable price. You are sort of, I think, saying to me that, as far as the SBA is concerned, you don't think there is any change that has been made.

Ms. HARRISON. What we have said is that there is such a long history of using "fair and reasonable price," which contracting agencies understand, that we assume that this would, in the end, end up being the way those contracting agencies look at price anyway.

Senator DIXON. If I may interrupt in the interest of time, in view of that, why not stay with what has worked all right?

Would you say "fair and reasonable" has worked all right?

Ms. HARRISON. Yes, we would.

Senator DIXON. Well, why change things? I don't know if there was any other intention.

Has anyone ever made a record that there was another intention involved in that?

Ms. HARRISON. I'm not aware of it, if there was.

Senator DIXON. In your department's look at the whole thing, and in looking at what was the expressed congressional intention on the House side, you didn't see any evidence that there was really a desire to change that—did you?

Ms. HARRISON. No.

The only thing that was brought to our attention was that there is currently a different standard for the 8(a) Program, and that is "fair market price" in that program, as contrasted with the Set-Aside Program, which uses "fair and reasonable."

We, I think, would agree with a number of the contracting agencies' testimony that perhaps not only should we have "fair and reasonable" for set-asides, but we might also want to impose that same standard for 8(a) contracts, having the same for both.

Senator **DIXON**. Then it is at least the position of the SBA that you would like to go along with the existing practice.

Ms. **HARRISON**. That's correct.

Senator **DIXON**. And "fair and reasonable" in your view is the existing practice and the one we should continue to follow.

It's worked well. It's given us decent competition and at the same time protects the taxpayers' interests in your view, and so forth?

Ms. **HARRISON**. Yes, we believe so.

Senator **DIXON**. OK. Thank you very much.

Now, on the question of goaling small business set-asides, the existing law is, at least until October 1, that you goal on the totality, is that right?

Ms. **HARRISON**. That's correct.

Senator **DIXON**. What this change would do is to direct you to goal on SICs.

Ms. **HARRISON**. That's correct.

Senator **DIXON**. What is your view of that?

Ms. **HARRISON**. Our view has been that, while we understand the perhaps intended purpose of doing that, we felt that, administratively, it would be extremely difficult.

First of all, it would be difficult because of the sheer number of SICs. But second, from a practical point of view, it is very difficult because currently the Federal Procurement Data System Center does not collect statistics that way.

Senator **DIXON**. Yes.

Ms. **HARRISON**. So there would be no baseline data for the contracting agencies.

Senator **DIXON**. Is it possible that there are as many as 1,100 SIC codes?

Ms. **HARRISON**. Yes, that is correct.

Senator **DIXON**. This Subcommittee is directed to be concerned about paperwork. It sounds to me like you are going to have a problem doing something like that.

Is that a fair evaluation of the situation?

Ms. **HARRISON**. I think it is a fair evaluation, and I think any concerns that we might have would certainly be overshadowed by those of the contracting agencies, who obviously would have to analyze the data and figure out where they were deficient in small business participation in certain SICs.

I think one thing we would want to say, though, is that we have related this in our thinking to the concern that was expressed by the House Committee that many agencies get all of the credit for small business participation in a very limited number of SICs. So, while they appear on paper to do very well or, in fact, do very well, it is sometimes seen that they do not take quite the initiative that they might in some of the SICs, where small businesses are underrepresented.

Senator DIXON. This 50 percent rule, the change that would be made effective October 1, requiring at least 50 percent of the work to be done by the successful bidder, my sense of all the testimony that I have seen here is that most people think that won't work, including some who apparently are not really excited about the bill we have introduced and, in general, prefer the changes. But I get a sense that most people think this is not workable. We want to protect against shams and front organizations. But, administratively, can't you do that without us having the problem of the 50 percent requirement?

Ms. HARRISON. In our notice of our intent to conduct this study, we included that subcontract limitation as an area where we wanted extensive public comment. Interestingly enough, the comments were fairly equally divided. There were a lot of people who said this will be a way of getting rid of fronts and shams and it will be a way of insuring that the dollars go where they are intended to go.

On the other hand, there were the comments about conventional industry practices, where in fact much more than 50 percent goes outside the firm. So we had a lot of comments, such as, "why couldn't you take the approach of if the subcontracts go to small businesses, you don't care what the percentage is."

I guess the point I am trying to make to you is that there was no clear consensus on this.

Senator DIXON. Well, apparently there is a majority consensus in the testimony here today. You say there was not, though, in what you had received.

The thought occurs to me—and I am just thinking in terms of something this Senator understands, and that is the general contractor—you know, there a lot of absolutely reputable general contractors—several I know personally—who are doggone good and do many, many, many millions of dollars of work a year, who basically subcontract practically all work. You know, they are just there, putting it all together with their experience and their know-how. That certainly is not a sham. That is just the way they do business.

It looks to me like that is perfectly reputable with nothing the matter with it.

Ms. HARRISON. We agree. We also know that that's the case in other industries. It has been brought to our attention, for example, in A&E.

Senator DIXON. So you don't feel any compelling need for that?

Ms. HARRISON. No, we don't.

Senator DIXON. I do not know this to be a fact but, theoretically, I suppose, at least on a spot check basis, you would try to be determining whether there is legitimacy in these things, would you not?

Ms. HARRISON. We would assume that that would be a consideration, both at the time the contract is awarded and later as a consideration through monitoring, as the contract progresses.

That was our other concern: how in the world do we monitor this? How do we insure that, even if at the beginning it appears to meet the statutory requirements, that it continues throughout the life of the contract to do that.

Senator DIXON. Now the one thing I think there was unanimity on—and that is very rare, I find, in the Congress—is the business of disclosing all the bidders prior to the award. Everybody thinks that is a bad idea.

Do you think it is a bad idea?

Ms. **Harrison**. We think it is a bad idea in terms of the benefits and the requirements involved.

We think, and we have been told, that it was intended to let the small business community know at the earliest stage when a large business might be pretending, or might certify itself to be small.

We don't think this is the way to address that.

We have an appeal procedure for size protests. That seems to work pretty well.

We think that, while it may sound good, it probably would administratively be extraordinarily difficult to administer and would not provide the benefits to small business.

Senator **Dixon**. As long as I have you here, even though it is not technically jurisdictional to this legislation, I would like to talk just a little bit about the 30 percent rule now.

As I understand what has happened in this DOD authorization bill that we adopted last year—which, incidentally, really was a kind of unilateral proposition; the Senate had no input at all in what we faced, so that people in the industry understand the problem—was that Senator Levin and I, as I recall, were the only Small Business Members on the Armed Services Committee, and we had a terribly contentious conference. At the end, everybody wanted a bill so badly and so desperately that conferees were agreeing on things in retrospect that I think we mistakenly agreed to.

In any event, on this, the very best we could do as a bottom line was just to put it off until October 1 of this year. I think it is really a shame, frankly, that this was done in that way.

If I understand this—and I am going to oversimplify it because we are "jacks of all trades" and generally experts on none—if I understand this 30 percent rule correctly, what will happen here is that there will be a very substantial diminution in numbers of participants categorized as small businesses as a consequence of this.

Will that not be true?

Ms. **Harrison**. Yes, it will be true.

Senator **Dixon**. When you take a total industry and make a determination of that total industry and then figure a 30 percent figure, then, as I understand it, those will be the ones that will participate or would be allowed to, but they won't all do so.

Ms. **Harrison**. That's correct.

Senator **Dixon**. So you will have the obvious reduction in numbers of participants here—and that's what the question I think ultimately before the Congress has to be. And that is somewhat contentious, you see, because you get some specific interests involved in this that are going to come at one another with full force.

That is why we tried to avoid it, frankly, in this one.

But I think it is something that we have to review sometime, and I would like to have your observations about it.

Ms. **Harrison**. Our chief concern about the 30 percent rule has been that adjusting the size standard may not be the way to limit small business set-asides in any particular industry because it is a hit and miss approach. We say well, rather than 30 percent of the set-aside and 8(a) contracts in Industry X having been awarded in these 3 years, it was 46 percent. Consequently, we have to figure some way of taking off 16 percent of small business set-asides and 8(a) awards.

This bill says to us that the way to do that is through adjusting the size standard. Well, creating the size standard was never a very precise mechanism in the first instance. To adjust it to what I call a magic number is an even less precise approach to doing it. We know that there are lots of other variables that affect when a set-aside is created.

So our concern is that even after we go through all of this and even after we then do take firms out of small business status, those contracts may still be awarded because the notion is that if you take a certain number of firms out, the set-aside will convert to an unrestricted procurement.

It will only be after 1 year or 2 or 3 of actual experience and analysis that we will know that such will be the case. But the impact on those firms which lost small business status will, of course, be immediate.

So, from a policy point of view, we have a concern.

Senator DIXON. Is there any question about the fact that it will reduce the numbers?

Ms. HARRISON. No. I think there is no question that it will reduce the numbers.

Senator DIXON. In other words, a lot of this is arguable. But if there is one clear thing, and, quite frankly, it is not addressed in this bill because we recognize that it is contentious, but if there is one clear thing, I think it is fair to state, is it not, that this will have some very significant impact in the industries as a whole around the country? There will be less small business participants as a consequence of that.

Is that not true?

Ms. HARRISON. Yes.

Senator DIXON. So you will make your judgment about that depending on your view as a Member of the Congress. But, clearly, that will be noticed, I think, most readily after October 1. The first impact you will see that is major will be that provision, I think. Is that a fair statement?

Ms. HARRISON. Yes, that is a fair statement.

Senator DIXON. I thank you Ms. Harrison. Thank you very much.

We now have a panel, consisting of Norma Leftwich, Director of the Office of Small and Disadvantaged Business Utilization in the Department of Defense, and Berton J. Roth, Director for Procurement and Assistance Management Directorate in the Department of Energy.

Would you like to proceed, Ms. Leftwich?

STATEMENT OF NORMA B. LEFTWICH, DIRECTOR, OFFICE OF SMALL AND DISADVANTAGED BUSINESS UTILIZATION, OFFICE OF THE SECRETARY OF DEFENSE

Ms. LEFTWICH. Thank you, sir.

I would ask that my entire testimony be submitted for the record and I will summarize, as appropriate.

Senator DIXON. Thank you, and I promise you that I read every word of it.

Ms. LEFTWICH. Thank you.

I am pleased to appear before your Subcommittee to testify on section 921 of P.L. 99.661.

I will first direct my remarks to this law and comment later on S. 1559, which proposes further modifications of certain provisions contained in the Authorization Act.

There is no question that we see difficulties in accomplishing the provisions of section 921(a) of P.L. 99–661. This section requires DOD to award a fair share of its prime contract awards to small businesses in each specific industrial classification, as opposed to the past, when the fair share has been based on total DOD prime contracts.

Since there is no standard definition of industrial classification, a worst case scenario could mean separate goals for over 800 standard industrial classifications for products and 303 standard industrial classifications for services.

A more reasonable definition would, in the case of DOD alone, would be to require goals for broader categories, such as the procurement claimant programs that we use, of which there are a total of 26.

Much depends upon how this requirement would be implemented through the goaling process.

Section 921(b) states that the cost of a set-aside contract to the awarding agency should not be allowed to exceed a fair market price, a term which is already defined in FAR. In this regard, it should be noted that FAR 19.806 deals with fair market price as it pertains to section 8(a) awards, which are, of course, made on a sole source basis.

This section does not pertain to set-asides which are made on the basis of competition and the consideration that the price must be fair and reasonable.

In essence, the marketplace establishes what is a "fair and reasonable" price.

We believe that the fair and reasonable standard worked well and is understood by the contracting community. We support a return to that terminology.

With regard to section 921(c), we support subcontracting limitations on small business set-asides since we adhere to the principle that the benefits of the Small Business Set-Aside Program should accrue to small business. We feel that there appears to be enough latitude to adjust these percentages as appropriate, as industry practices require.

Section 921(d) revises section 15(g) of the Small Business Act to require small business goals to be established on all contracts regardless of dollar value, rather than on contracts valued over $10,000.

The DOD has always goaled every dollar since 1953, and this requirement has not imposed a great administrative burden. Perhaps here it would be important to explain why we have goaled every dollar since that time.

Although P.L. 95–507 reserved all awards under $10,000, now revised to $25,000 for small firms, such is not the practice within the

Department of Defense, simply because some items are too complex, others are proprietary, others are basic ordering agreements with big business.

This is far too big an opportunity market we feel not to goal. Small firms are capturing only 54.8 percent of the opportunity market under $25,000 and only 37.2 percent by set-aside. So we consider it an important area to keep a focus on.

Section 921(d) requires the head of each Federal agency to make consistent efforts to expand annually participation by small firms in each industry category. We continually do this by our strong Out-Reach Program, which encompasses some 30 Federal procurement conferences held around the Country, and approximately 100-plus procurement conferences on local levels throughout the Country.

With regard to disclosing the names of prospective offerors, we believe that the availability of such information could make it possible for collusion among bidders, and that there is no assurance that even specific firms which are solicited will respond to a solicitation. Of greater concern at the agency level is the increased workload this will put contracting personnel who are already overburdened with administrative details.

On section 921(f), requiring the SBA to revise size standards when set-asides exceed 30 percent, I would make but one observation. We concur with SBA's difficulty in coming up with the magic numbers, and we note that primarily what is provided for is a downward adjustment of these standards to establish and maintain the 30 percent level.

We would only question whether there are provisions that would authorize the upward establishment of those numbers, where indicated.

With regard now to S. 1559, in terms of reestablishing the small business fair share criteria, we support that provision because, as I mentioned earlier, the fair share in each industry category is extremely problematic and the results will not offset the difficulties.

However, it is important to acknowledge that section 921 was a response to an environment that was created by heavy reliance upon a few industries to make up the lion's share of small business awards. This, in turn, created the problem concerning industry attacks on the "Rule of Two," which is so vitally important to the Small Business Set-Aside Program.

Again, we support a return to the terminology of "fair and reasonable" price.

We support goaling below $25,000, and we support subcontracting limitations, as long as there is flexibility in establishing those.

This concludes my formal presentation, sir.

I will be happy to answer any questions.

[The prepared statement of Ms. Leftwich follows:]

HOLD UNTIL RELEASED
BY THE COMMITTEE

THE DEPARTMENT OF DEFENSE

STATEMENT ON SECTION 921, PUBLIC LAW 99-661

THE FY 1987 DEPARTMENT OF DEFENSE
AUTHORIZATION ACT

BY
NORMA LEFTWICH
DIRECTOR, OFFICE OF SMALL AND DISADVANTAGED
BUSINESS UTILIZATION, OFFICE OF THE
SECRETARY OF DEFENSE

BEFORE THE

SUBCOMMITTEE ON GOVERNMENT CONTRACTING
AND PAPER WORK REDUCTION

COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

SEPTEMBER 21, 1987

MR. CHAIRMAN:

I AM PLEASED TO APPEAR BEFORE YOUR SUBCOMMITTEE TO TESTIFY ON SECTION 921 OF PUBLIC LAW 99-661, THE FY 1987 DEPARTMENT OF DEFENSE AUTHORIZATION ACT, WHICH REVISED SEVERAL PROVISIONS REGARDING THE SMALL BUSINESS ACT AS IT PERTAINS TO THE CONCEPT OF "FAIR SHARE", SET-ASIDES, FAIR MARKET PRICE, AND OTHER FACTORS. I WILL FIRST DIRECT MY REMARKS TO THIS LAW AND COMMENT LATER ON S.1559 WHICH PROPOSES FURTHER MODIFICATIONS OF CERTAIN PROVISIONS OF THE SMALL BUSINESS SET-ASIDE PROGRAM.

THE DEPARTMENT OF DEFENSE (DoD) POSITION ON SECTION 921 OF PUBLIC LAW 99-661 WAS PREVIOUSLY CONVEYED TO SENATOR ALAN J. DIXON OF THE SENATE SMALL BUSINESS COMMITTEE BY THE UNDER SECRETARY OF DEFENSE (ACQUISITION), MR. RICHARD GODWIN, ON FEBRUARY 6, 1987. MY COMMENTS ARE BASED ON THAT SUBMISSION.

THERE IS NO QUESTION THAT WE SEE DIFFICULTIES IN ACCOMPLISHING THE PROVISIONS OF SEC. 921(a) OF PUBLIC LAW 99-661. THIS SECTION REQUIRES DoD TO AWARD A FAIR SHARE OF ITS PRIME CONTRACT AWARDS TO SMALL BUSINESS IN EACH SPECIFIC INDUSTRIAL CLASSIFICATION AS OPPOSED TO THE PAST WHEN THE FAIR SHARE HAS BEEN BASED ON TOTAL DOD PRIME CONTRACT AWARDS. SINCE THERE IS NO STANDARD DEFINITION OF "INDUSTRIAL CLASSIFICATION," A WORSE CASE SCENARIO COULD MEAN SEPARATE GOALS FOR OVER 800 STANDARD INDUSTRIAL CLASSIFICATIONS FOR PRODUCTS AND 303 STANDARD INDUSTRIAL CLASSIFICATIONS FOR SERVICES. A MORE REASONABLE DEFINITION WOULD, IN THE CASE OF

DOD, REQUIRE GOALS FOR BROADER CATEGORIES SUCH AS THE PROCUREMENT CLAIMANT PROGRAMS OF WHICH THER ARE A TOTAL OF 26.

NOTWITHSTANDING WHICH DEFINITION IS USED, AT LEAST THREE ELEMENTS OF INFORMATION, IT SEEMS TO US, WOULD BE REQUIRED. THESE ARE A DETERMINATION OF WHAT THE CURRENT SHARE IS, WHAT THE FAIR SHARE SHOULD BE (WHICH REQUIRES A COMPREHENSIVE KNOWLEDGE OF CAPABILITY AND CAPACITY OF THE NATION'S SMALL BUSINESS COMMUNITY), AND DATA ON THE LAST TWO YEAR'S PROCUREMENT HISTORY FOR EACH CATEGORY. THIS REPRESENTS A MAJOR ADMINISTRATIVE AND ANALYTICAL TASK.

SEC. 921(b) STATES THAT "A CONTRACT MAY NOT BE AWARDED UNDER THIS SUBSECTION IF THE AWARD OF THE CONTRACT WOULD RESULT IN A COST TO THE AWARDING AGENCY WHICH EXCEEDS A FAIR MARKET PRICE". FURTHER, IT SHOULD BE NOTED THAT HOUSE REPORT 99-718, "NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 1987" IN SECTION 911 STATES "....THE COST OF A SET-ASIDE CONTRACT TO THE AWARDING AGENCY WOULD NOT BE ALLOWED TO EXCEED A "FAIR MARKET PRICE", A TERM WHICH IS ALREADY DEFINED IN FEDERAL ACQUISITION REGULATIONS (FAR)." IN THIS REGARD, IT SHOULD BE NOTED THAT FAR 19.606 DEALS WITH FAIR MARKET PRICE AS IT PERTAINS TO THE SECTION 8(a) SMALL DISADVANTAGED BUSINESS PROGRAM UNDER WHICH AWARDS ARE MADE ON A SOLE SOURCE BASIS. THIS SECTION DOES NOT PERTAIN TO SET-ASIDES WHICH ARE MADE ON THE BASIS OF COMPETITION AND THE CONSIDERATION THAT THE PRICE MUST BE "FAIR AND REASONABLE."

TO DETERMINE THAT A PRICE IS A "FAIR MARKET PRICE" IN THE SECTION 8(a) PROGRAM REQUIRES A REVIEW OF PROCUREMENT HISTORY (SEARCH OF INDIVIDUAL CONTRACT FILES FOR EACH AWARD) WHEREAS A "FAIR AND REASONABLE PRICE" INVARIABLY IS THE LOWEST PRICE OFFERED ON A COMPETITIVE PROCUREMENT WHERE THERE ARE TWO OR MORE OFFERORS. IN ESSENCE, THE MARKETPLACE ESTABLISHES WHAT IS A "FAIR AND REASONABLE PRICE." IF "FAIR MARKET PRICE" AND "FAIR AND REASONABLE" ARE CONSIDERED TO BE SYNONYMOUS, THEN NO DIFFICULTIES WILL BE EXPERIENCED. IF THESE TERMS ARE NOT SYNONYMOUS, THEN SIGNIFICANT DELAYS WILL OCCUR IN THE PROCUREMENT PROCESS, AND CONTRACTING OFFICERS IN ALL LIKELIHOOD WILL BE RELUCTANT TO MAKE SMALL BUSINESS SET-ASIDES. WE BELIEVE THAT THE "FAIR AND REASONABLE" STANDARD WORKED WELL AND WAS UNDERSTOOD BY THE CONTRACTING COMMUNITIY. WE SUPPORT A RETURN TO THAT TERMINOLOGY.

SECTION 921(C) STATES THAT A SMALL BUSINESS CONCERN MAY NOT BE AWARDED A CONTRACT UNLESS THE CONCERN AGREES THAT:

(i) IN THE CASE OF A CONTRACT FOR SERVICES (EXCEPT CONSTRUCTION) AT LEAST 50 PERCENT OF THE COST OF THE CONTRACT PERFORMANCE INCURRED FOR PERSONNEL SHALL BE EXPENDED FOR EMPLOYEES OF THE CONCERN;

(ii) IN THE CASE OF A CONTRACT FOR PROCUREMENT OF SUPPLIES (OTHER THAN PROCUREMENT FROM A REGULAR DEALER IN SUCH SUPPLIES), THE CONCERN WILL PERFORM FOR AT LEAST 50 PERCENT OF

THE COST OF MANUFACTURING THE SUPPLIES (NOT INCLUDING THE COST OF MATERIALS).

WE SUPPORT SUBCONTRACT LIMITATIONS ON SMALL BUSINESS SET-ASIDES SINCE WE ADHERE TO THE PRINCIPLE THAT THE BENEFITS OF THE SMALL BUSINESS SET-ASIDE PROGRAM SHOULD ACCURE TO SMALL BUSINESS. THIS IS CONSISTENT WITH THE SUBCONTRACTING LIMITATIONS IMPOSED ON 8(A) PROGRAM PARTICIPANTS.

SECTION 921(d)(1) REVISES SECTION 15 (g) OF THE SMALL BUSINESS ACT TO REQUIRE SMALL BUSINESS GOALS TO BE ESTABLISHED ON ALL CONTRACTS REGARDLESS OF DOLLAR VALUE RATHER THAN ON CONTRACTS VALUED OVER $10,000 WHICH WAS REQUIRED IN PUBLIC LAW 95-507, PASSED ON OCTOBER 24, 1978. THE DOD HAS ALWAYS GOALED EVERY PROGRAM SINCE 1953 AND THIS REQUIREMENT HAS NOT IMPOSED A GREAT ADMINISTRATIVE BURDEN..

SECTION 921(d)(2) REQUIRES THE HEAD OF EACH FEDERAL AGENCY TO MAKE CONSISTENT EFFORTS TO EXPAND ANNUALLY, PARTICIPATION BY SMALL BUSINESS IN EACH INDUSTRY CATEGORY TO INCLUDE PARTICIPATION BY SMALL DISADVANTAGED BUSINESS CONCERNS. WE CONTINUALLY DO THIS BY OUR SUPPORT OF APPROXIMATELY 30 OF THE FEDERAL PROCUREMENT CONFERENCES HELD ANNUALLY BY MEMBERS OF CONGRESS IN THEIR LOCAL CONSTITUENCIES. ADDITIONALLY, WE SUPPORT APPROXIMATELY 75-100 PROCUREMENT CONFERENCES ON A LOCAL LEVEL THROUGHOUT THE COUNTRY. SUPPORT IS ALSO PROVIDED TO SMALL BUSINESS TRADE ASSOCIATIONS SUCH AS THE NATIONAL TOOLING AND MACHINERY ASSOCIATION, THE

ASSOCIATION OF SMALL RESEARCH, ENGINEERING AND TECHNOLOGY COMPANIES, THE BLACK BUSINESS ASSOCIATION OF LOS ANGELES AND SEVERAL OTHERS. THE DEPARTMENT OF DEFENSE HAS ESTABLISHED 67 PROCUREMENT TECHNICAL ASSISTANCE AGREEMENTS WITH STATE, COUNTY AND NON-PROFIT ORGANIZATIONS THROUGHOUT THE COUNTRY WHICH ARE FUNDED IN PART BY DoD TO ESTABLISH ORGANIZATIONS WHICH WILL HELP SMALL BUSINESS FIRMS IN THEIR LOCALITIES TO DO BUSINESS WITH DoD.

SECTION 921(e) REQUIRES THE HEAD OF ANY FEDERAL AGENCY TO, WITHIN FIVE DAYS OF THE AGENCY'S DECISION TO SET-ASIDE A PROCUREMENT FOR SMALL BUSINESS TO PROVIDE THE NAMES AND ADDRESSES OF SMALL BUSINESS CONCERNS EXPECTED TO RESPOND TO THE PROCUREMENT TO ANY PERSON WHO REQUESTS SUCH INFORMATION. THE AVAILABILITY OF SUCH INFORMATION COULD MAKE IT POSSIBLE FOR COLLUSION TO OCCUR AMONG BIDDERS. IT WILL BE DIFICULT TO ASSURE ACCOMPLISHMENT OF THIS REQUIREMENT AS THERE IS NO ASSURANCE THAT EVEN SPECIFIC FIRMS WHICH ARE SOLICITED WILL RESPOND TO A SOLICITATION. OF GREATER CONCERN IS THE INCREASED WORKLOAD THIS WILL PUT ON CONTRACTING PERSONNEL WHO ARE ALREADY OVERBURDENED WITH ADMINISTRATIVE DETAILS.

SECTION 921(f) REQUIRES THE SMALL BUSINESS ADMINISTRATION TO REVIEW CERTAIN INDUSTRIES WHERE SMALL BUSINESS SET-ASIDES EXCEED THIRTY PERCENT OF TOTAL PRIME CONTRACT AWARDS, AND WHERE THIS OCCURS TO ADJUST THE SIZE STANDARD DOWNWARD TO REACH THAT FIGURE. I WOULD LIKE TO MAKE

THE FOLLOWING OBSERVATIONS. WHEREAS THE HOUSE REPORT ON PUBLIC LAW 99-661 PROVIDED FOR UPWARD AND DOWNWARD ADJUSTMENT OF THESE STANDARDS TO ESTABLISH AND MAINTAIN THE THIRTY PERCENT LEVEL, THE LAW ONLY PROVIDES FOR THE DOWNWARD REDUCTION. IN THIS REGARD, IT SHOULD BE NOTED THAT OUR SET-ASIDES FOR ARCHITECTURAL AND ENGINEERING (A-E) SERVICES HAVE DECLINED FROM 58.1 PERCENT IN FY 1982 TO 12.8 PERCENT IN FY 1986, AND ARE DOWN TO 8.2 PERCENT AS OF THE THIRD QUARTER OF FY 1987. MOST OF THIS REDUCTION CAN BE ATTRIBUTED TO THE $85,000 CAP ON THESE SET-ASIDES. WITHIN THE LAST YEAR THE A-E SIZE STANDARD HAS BEEN REDUCED FROM $7.5 MILLION TO $2.5 MILLION. THE CAP AND THIS SIGNIFICANTLY REDUCED SIZE STANDARD ARE GOING TO GREATLY REDUCE TO OVERALL AWARDS TO SMALL BUSINESS IN THIS AND SUCCEEDING FISCAL YEARS. PROVISIONS SHOULD BE MADE TO AUTHORIZE UPWARD REVISIONS WHERE INDICATED.

SIZE STANDARDS IN THE CONSTRUCTION INDUSTRY ARE BEING CONSIDERED FOR REDUCTION FROM THE $17.0 MILLION FIGURE TO CATEGORIES RANGING FROM $1.25 MILLION TO $9.75 MILLION. AN SBA REVIEW IN FOUR INDUSTRIES OF SMALL CONTRACTORS WHO WON SET-ASIDE AWARDS INDICATES THAT FROM 30.8 PERCENT TO 57.0 PERCENT OF THE FIRMS WILL NOW BE CONSIDERED BIG BUSINESS SOLELY BY ADMINISTRATIVE FIAT.

THESE REDUCED SIZE STANDARDS WILL ADVERSELY AFFECT THE DOD CONSTRUCTION ACTIVITIES WHICH DURING FY 1986 AWARDED $7.6 BILLION TO ALL FIRMS, OF WHICH $5.1 BILLION WAS AWARDED TO

SMALL BUSINESS. NOW, THESE AWARDS WILL BE SIGNIFICANTLY REDUCED BECAUSE THE CONSTRUCTION SMALL BUSINESS COMMUNITY WILL ALSO BE DRASTICALLY REDUCED. THIS CONDITION WILL ALSO HAVE A BEARING ON OUR NEGOTIATIONS WITH SBA FOR THE ESTABLISHMENT OF THE DOD FY 1988 SMALL BUSINESS GOALS.

I WILL NOW ADDRESS MY REMARKS TO S.1559 WHICH SENATORS DIXON, BUMPERS AND WEICKER INTRODUCED CERTAIN PROVISIONS TO THE SMALL BUSINESS ACT RELATING TO THE SMALL BUSINESS SET-ASIDE PROGRAM.

SECTION 2(1) OF S.1559 WOULD AMEND SECTION 15(A) OF THE ACT BY RE-ESTABLISHING THAT THE SMALL BUSINESS "FAIR SHARE" CRITERIA WILL BE BASED ON AN AGENCY'S TOTAL AWARDS, NOT BASED ON A FAIR SHARE BASED "IN EACH INDUSTRY CATEGORY." THE DEPARTMENT OF DEFENSE SUPPORTS THIS PROVISION OF THE BILL BECAUSE, AS I MENTIONED EARLIER, THE FAIR SHARE "IN EACH INDUSTRY CATEGORY" IS EXTREMELY PROBLEMATIC AND THE RESULTS WILL NOT OFFSET THE DIFFICULITIES. HOWEVER, IT IS IMPORTANT TO ACKNOWLEDGE THAT SECTION 921 WAS A RESPONSE TO THE ENVIRONMENT THAT WAS CREATED BY HEAVY RELIANCE UPON A FEW INDUSTRIES TO MAKE UP THE LIONS SHARE OF SMALL BUSINESS AWARDS. THIS IN TURN CREATED THE PROBLEM CONCERNING INDUSTRY ATTACKS ON THE RULE OF TWO - WHICH IS SO VITALLY IMPORTANT TO THE SMALL BUSINESS SET-ASIDE PROGRAM.

SECTION 2 (3) OF S.1559 WOULD REVISE SECTION 15(A) FURTHER BY DELETING THE TERM "FAIR MARKET PRICE" AND REPLACE

SAME WITH "FAIR AND REASONABLE PRICE." WE STRONGLY SUPPORT THIS CHANGE BECAUSE THE "FAIR AND REASONABLE PRICE" TERM HAS BEEN USED FOR OVER THIRTY YEARS, IS EASILY UNDERSTOOD BY BUYERS, IS SIGNIFICANTLY EASIER TO APPLY, AND EXPEDITES THE PROCUREMENT PROCESS WHILE AT THE SAME TIME ASSURING THAT THE GOVERNMENT PAYS ONLY COMPETITIVE PRICES WHICH ARE "FAIR AND REASONABLE."

SECTION 3 OF S.1559 WOULD AMEND 15(G) OF THE SMALL BUSINESS ACT BY STATING THAT THE HEADS OF AGENCIES SHALL, AFTER CONSULTATION WITH THE SBA, ESTABLISH GOALS FOR CONTRACTS HAVING A VALUE OF OVER $25,000. DOD HAS GOALED EVERY ONE OF ITS PROCUREMENT DOLLAR AWARDS REGARDLESS OF DOLLAR VALUE SINCE THE BEGINNING OF THE SMALL BUSINESS PROGRAM IN 1953. THE REASON FOR THIS IS THAT AWARDS VALUED UNDER $25,000 AMOUNTED TO $10.5 BILLION IN FY 1986. OF THIS AMOUNT, ONLY $5.8 BILLION OR 54.8 PERCENT WAS AWARDED TO SMALL BUSINESS, EVEN THOUGH THE LAW STATES THAT AWARDS VALUED UNDER $25,000 WILL BE RESERVED FOR SMALL BUSINESS. OF THE TOTAL AWARDS OF $10.5 BILLION, ONLY $3.9 BILLION OR 37.2 PERCENT WAS SET-ASIDE FOR THE EXCLUSIVE PARTICIPATION OF SMALL BUSINESS. THE REASON SUCH AWARDS WERE NOT AND CANNOT BE AWARDED TO SMALL BUSINESS IS THAT SOME ITEMS REQUIRE SUCH DIFFICULT PROCESSES THAT ONLY LARGE BUSINESS CAN PROVIDE WHILE OTHER ITEMS UNDER $25,000 ARE PROPRIETARY TO LARGE BUSINESS. THE ISSUE DOES NOT TURN ON THE LOW DOLLAR VALUE OF THE REQUIREMENT, BUT RATHER ON WHETHER A

SMALL BUSINESS CAN PRODUCE THE ITEM AT A FAIR AND REASONABLE PRICE. NEVERTHELESS, THE CATEGORY OF "AWARDS VALUED UNDER $25,000" REPRESENTS A SMALL BUSINESS OPPORTUNITY MARKET JUST TOO LARGE TO ESCAPE THE GOALING PROCESS. WE RECOMMEND STRONGLY THAT ALL AWARDS MADE TO UNITED STATES BUSINESS FIRMS, REGARDLESS OF DOLLAR VALUE, BE GOALED. THIS IS PARTICULARLY IMPORTANT BECAUSE OF THE FIVE PERCENT MINORITY GOAL PLACED ON DOD BY P.L. 99-661, THE FY 1987 DEFENSE AUTHORIZATION ACT.

SECTION 4 OF S.1559 WOULD MODIFY THE CURRENT FIFTY PERCENT RULE WHICH MANDATES THAT A SMALL BUSINESS FIRM WHICH RECEIVES AN AWARD IN A SMALL BUSINESS SET-ASIDE MUST AGREE THAT AT LEAST FIFTY PERCENT OF THE COSTS INCURRED WILL BE BY THE FIRM UTILIZING ITS OWN IN-HOUSE RESOURCES. SECTION 4 WOULD CHANGE THE MANDATORY REQUIREMENT TO A "BEST EFFORTS" REQUIREMENT. AS I MENTIONED EARLIER, I BELIEVE BENEFICIARIES OF SMALL BUSINESS SET-ASIDES SHOULD BE SMALL BUSINESS FIRMS. ACCORDINGLY, WE SUPPORT SUBCONTRACTING LIMITATIONS WITH SOME FLEXIBILITY.

SECTION 5 OF S.1559 WOULD REPEAL THE REQUIREMENT TO PROVIDE NAMES OF SMALL BUSINESS FIRMS EXPECTED TO RESPOND TO A SMALL BUSINESS SET-ASIDE SOLICITATION. WE CONCUR IN THIS REPEAL AS IT WILL SAVE A SIGNIFICANT AMOUNT OF ADMINISTRATIVE EFFORT AND EXPENSE.

THIS CONCLUDES MY PRESENTATION. I WILL BE HAPPY TO ANSWER ANY QUESTIONS YOU MAY HAVE.

Senator DIXON. Thank you, Ms. Leftwich.

If we could hear next from Mr. Roth and then go to questions for both of you.

STATEMENT OF BERTON J. ROTH, DIRECTOR, PROCUREMENT AND ASSISTANCE MANAGEMENT DIRECTORATE, U.S. DEPARTMENT OF ENERGY

Mr. ROTH. Thank you. If I may, I would like to submit my complete statement for the record and just summarize our opinions, observations, and conclusions with regard to the enacted amendments in the Small Business Act. Also, we will have some comments on S. 1559.

First, with regard to the enacted amendments, we believe that some features will clearly work against small and small disadvantaged business participation. Others appear to serve a positive purpose, but their implementation will work counter to the interests of small and small disadvantaged business and will have a negative impact on the procurement process.

Let me briefly mention the specific features that trouble us: First, the 30 percent rule, that the SBA so ably discussed in its report. Second, the use of standard industrial classification codes for establishing levels of small and small disadvantaged participation raises many practical problems in implementation. Third, goaling of small purchases will create a logistical nightmare as we attempt to track by SIC code, and it will add millions of data elements to an already overburdened data system. Fourth, subcontracting limitations are well intended, but will result in problems, particularly enforcement of this provision when the award results from the setting aside of sealed bid procurements.

Finally, the potentially most disruptive provision is the requirement that a list of potential bidders be provided, if requested, within 5 days of a set-aside decision. This will negatively impact on our very successful class Set-Aside Program. The reported purpose of this provision is to allow early identification of size misrepresentation, a very rare occurrence in our experience.

So as not to be totally negative, we do believe that the amendments of section 922 serve a positive purpose in increasing the threshold for publication in the "Commerce Business Daily" to $25,000, and, likewise, increasing the small purchase class set-aside for small business from $10,000 to $25,000.

In your invitation to this hearing, you asked our impressions of the effects of S. 1559. Given our concerns about the 1986 amendments to the Small Business Act, we support many of the provisions of the bill.

First, and from a procurement process standpoint, most importantly, S. 1559 would repeal the amendments requiring agencies to make available a list of small business concerns "expected to respond to the procurement" within 5 days of the decision to set the solicitation aside for small business. We fully support such a repeal.

Second, section 3 of the bill would raise the goaling threshold from zero dollars to $25,000. We fully agree with this proposed change.

Next, the limitations on subcontracting are to be accomplished on a "best efforts" basis. This change introduces some of the flexibility we believe is necessary.

The fourth major change prescribed by S. 1559 is generally replacing the use of SIC codes with product and service codes. We believe this change partially recognizes the reality of the procurement world. But to fully accomplish this objective, the agency goaling paragraph of section 15(g), added by section 921(d)(2), should be deleted in its entirety. We believe goaling should be done, as now, on the basis of overall award.

The required goaling, whether internal or external to the agency, to be done on such a detailed basis as SIC codes or even based on product and service code, will complicate and disrupt the goaling process with no corresponding advantage.

The bill would also substitute "fair and reasonable price" for "fair market price" in small business set-aside awards. Fair and reasonable price is the standard we in Government procurement use every day. Since it conforms to our normal way of doing business, esoteric debate over the differences between the two terms would be eliminated.

We suggest a parallel substitution of "fair and reasonable price" for "fair market price" for the 8(a) awards also.

In conclusion, S. 1559 goes a long way in treating our concerns and we would like to work with you to make it even more effective.

Thank you.

[The prepared statement of Mr. Roth follows:]

STATEMENT OF BERTON J. ROTH,
DIRECTOR, PROCUREMENT AND ASSISTANCE MANAGEMENT DIRECTORATE, DEPARTMENT OF ENERGY, BEFORE THE SUBCOMMITTEE ON GOVERNMENT CONTRACTING AND PAPERWORK REDUCTION OF THE SENATE SMALL BUSINESS COMMITTEE

SEPTEMBER 21, 1987

Good morning Mr. Chairman and members of the subcommittee. My name is Berton J. Roth. I am the Director of the Department of Energy's Procurement and Assistance Management Directorate and the Procurement Executive for the Department.

It is a pleasure for me to appear before you today to discuss the amendments to the Small Business Act that were contained in the Defense Acquisition Improvement Act of 1986 in Public Laws 99-500, 99-591, and 99-661. I will also offer my comments on S.1559, which would modify those amendments.

At the outset I would like to note that the highest levels of management of the Department of Energy support and are proud of the Department's achievements in providing the maximum practicable opportunity for small and small disadvantaged business to participate in the award of DOE's prime contracts and subcontracts.

As I stated in my letter to you of February 5, 1987, we are working with the appropriate regulatory agencies to assure compliance with the amendments. However, we still believe that some of these amendments will work directly against small and small disadvantaged business participation. Others appear to serve a positive purpose, but their implementation may indirectly work counter to the interests of small and small disadvantaged business. Still other of the amendments will have significant negative impact, both on the procurement process and the setting aside of procurements for small business. The apparent purpose of the amendments in this latter category is to solve problems that do not warrant statutory action. We do know, however, that as long as these amendments remain in effect, agencies must implement them or risk being found in violation of the law. I would like to expand upon these observations.

The amendments establish a target level of 30 percent of total contract dollars for award through small business set-asides and the 8(a) program in four industries: construction, shipbuilding and ship repair, architectural and engineering services, refuse systems and related services, in which small businesses receive a significant share of Federal awards. However, since firms involved in those industries tend to be small businesses, the only way to reduce the proportion of awards by small business set-aside and 8(a) procurements is, as the SBA has proposed in its report to Congress, to significantly lower the size standards, thereby excluding many current small and small disadvantaged businesses from competition in small business set-asides and from receiving 8(a) awards. Since agencies must set aside any procurement for which there is a substantial likelihood of receiving reasonably priced bids or proposals from at least two responsible small businesses, the size standard will have to be reduced even further to achieve the statutory purpose.

Businesses classified as small under current size standards may lose a significant share of Federal contracting dollars beginning in October in those four designated industries.

The amendments also lay a foundation for goaling of small business and small disadvantaged business participation by Standard Industrial Classification (SIC) code. As I stated in my February letter, the use of SIC codes as a basis for establishing levels of small business and small disadvantaged business participation in Federal contracting raises many practical problems. We have no SIC code history, and our current commodity and product service code data do not translate into SIC code data. In order to be meaningful, a year's history, at a minimum, would be necessary to establish internal targets or external goals. The SIC based goaling system is to be effective October 1, 1987. As it now stands the Federal Procurement Data System will not require collection of SIC data until FY 1989.

From a procurement standpoint, the amendments at section 922 serve a positive purpose in increasing the threshold for publication in the Commerce Business Daily to $25,000 and likewise in increasing the small purchase class set-aside for small business from $10,000 to $25,000.

However, under the amendments, for the first time, goaling is to include, small purchase transactions. This change adds a new dimension to the SIC goaling process mentioned above. According to the Federal Procurement Data System, there were over 20 million transactions falling into the less than $25,000 category Government-wide during FY 1986. In the Department of Energy alone, we had over 50,000 such transactions. We foresee a logistical nightmare in attempting to goal to the $0 level and in obtaining millions of additional data elements, such as detailed SIC codes, for all these transactions. Interestingly, the SIC data is of absolutely no use to DOE.

As an example of well-intended legislation resulting in unintended problems, I would like to cite section 921(c) of the amendments. This section provides that, in the case of a service contract (other than construction), a small business, receiving an award under a small business set-aside, must perform at least 50 percent of the cost of the contract and, in the case of a contract for supplies, must perform at least 50 percent of cost of manufacture, excluding cost of materials. This provision is intended to preclude improperly brokered set-aside awards. We agree with the intent of this provision. However, we have reservations about its implementation.

We are concerned about enforcement of this provision when the award results from the setting aside of a sealed bid procurement. Currently, in set-aside, sealed bid procurements contracting officers are concerned only about low responsive, responsible bids, and, additionally, in the case of supplies, that the source of the successful small business goods is a small business. However, section 921(c) requires consideration of incurred costs. These costs are known only after contract performance. Enforcement could entail post-performance audits and will require additional small business contractor recordkeeping requirements in set-aside contracts. These burdens are contrary to the concept of and negate many of the benefits of sealed bid procurement.

Further, the 50 percent subcontracting limitations may not reflect conventional practice in many industries; yet, by its statutory nature, section 921(c) does not provide deviation authority to treat individual cases. The intended remedies for violations of this provision also are not apparent, and, we believe, these subcontracting limitations will reduce the level of competition in small business set-asides beyond that caused by the adjusted size standards.

Concerning the procurement process itself, section 921(e) of the amendments is potentially the most damaging. This view has also been reflected by the SBA in its report to Congress. That section provides that "the head of any Federal agency shall, within five days of the agency's decision to set aside a procurement for small business concerns under this section, provide the names and addresses of small business concerns expected to respond to the procurement to any person who requests such information."

DOE makes class set-aside determinations for many commodities and services. Each DOE procuring office may make its own class set-aside determinations based upon its individual experience. We frequently decide to set procurements aside based upon past history, before any bidders list is created. We also decide to set procurements aside before publication in the Commerce Business Daily. That publication often significantly increases the size of any bidders list. All of these processes will be upset and detrimentally affected by section 921(e). Either the decision to set a procurement aside will have to be made later in the process, thereby effectively eliminating class set-asides, or premature or incomplete information will be provided to the requesters. In either case, the procurement leadtimes will be extended. The only explanation we could find for this provision was that it was intended to allow the early identification of large firms that improperly represent themselves as small businesses. The misrepresentation of size is very rare in our experience, and there are existing, effective remedies--the SBA size standards appeals process and suspension or debarment of violators. We question the wisdom of altering the procurement process and creating a practical reason for not setting procurements aside to solve a problem that effectively does not exist.

In your invitation to this hearing, you asked our impressions of the effects of S.1559. Given the concerns expressed above about the 1986 amendments to the Small Business Act, we support many of the provisions of the bill.

First and, from a procurement process standpoint, most importantly, S.1559 would repeal section 921(e) of the amendments to the Small Business Act, requiring agencies to make available a list of small business concerns "expected to respond to the procurement" within five days of the decision to set the solicitation aside for small business. We fully support such a repeal.

Secondly, section 3 of the bill would raise the goaling threshold from $0 to $25,000. As evidenced by our earlier discussion on this matter, we see benefits resulting from this proposed change.

Next, the limitations on subcontracting contained in section 921(c) of the amendments for small business set-asides and 8(a) awards are to be accomplished on a best efforts basis. This change introduces some of the flexibility we believe is necessary in this area. The clarification of the effective date of these limitations in section 4(b) of S.1559 is also welcome; however, we question the ability of a contracting officer to meaningfully evaluate the need for adjustment of the subcontracting thresholds on an individual procurement.

The fourth major change that would be prescribed by S.1559 is generally replacing the use of SIC codes with product and service codes. We believe this change recognizes the reality of the procurement world, but, to fully accomplish this objective, the agency goaling paragraph of section 15(g), added by section 921(d)(2), should be deleted in its entirety. We believe that small business, 8(a), and related goaling should be done, as now, on the basis of overall awards to those classes of contractors. To require goaling, whether internal or external to the agency, to be done on such a detailed basis as SIC code or even based on product and service code will complicate and disrupt the goaling process with no corresponding advantage. We believe this deletion would be consistent with the spirit and intent of section 2 of S.1559.

The bill would also substitute "fair and reasonable price" for "fair market price" in small business set-aside awards. "Fair and reasonable price" is a standard we in Government procurement use every day. Since it conforms to our normal way of doing business, esoteric debate over the differences between the two terms would be eliminated.

We suggest a parallel substitution of "fair and reasonable price" for "fair market price" for 8(a) awards. That additional change is appropriate for the same reasons the substitution is proposed for small business set-aside awards.

In summary, the Department of Energy will do its best to work with the appropriate regulatory agencies to meaningfully implement sections 921 and 922 of the Defense Acquisition Improvement Act of 1986. We have major reservations about their impact upon the ability of the Federal government and DOE to assure fair participation of small and small disadvantaged business in the procurement process. We are also concerned about our ability to overcome certain data collection and procurement process problems created by their enactment. The difficulties in the areas of SIC goaling of small and small disadvantaged business contracting, the statutory nature of the limit on subcontracting, and the duty to make available a list of prospective bidders within five days of the decision to set a procurement aside are particularly worrisome.

S.1559 goes a long way in treating our concerns. That bill could be made even more effective, particularly with the repeal of the goaling paragraph added by section 921(d)(2) of last year's amendments.

I will be happy to answer any questions you may have.

Senator DIXON. Thank you, Mr. Roth.

Let me see whether I can capsulize the positions that you and Ms. Leftwich take here, so that we have it on the record, because you represent, in the case of Ms. Leftwich, Defense, and in your case, Energy, two major participants that I am sure the Congress would want to support if it is within the philosophical acceptability of a majority in both places.

You are both saying, are you not, that "fair and reasonable" prices worked OK and there is no reason to change it?

Mr. ROTH. That's correct.

Ms. LEFTWICH. That is correct, sir.

Senator DIXON. In other words, you are maybe even saying—I think Ms. Leftwich did in her remarks—that as far as she is concerned, fair market price is fair and reasonable price. This I think is the sense of what I got from everybody's testimony more or less.

Why change it? Stick with fair and reasonable, it's worked all right for you. Is it fair to say that you are both saying that?

Mr. ROTH. I believe so. Yes, Senator.

Ms. LEFTWICH. Yes, sir.

Senator DIXON. OK. Then that is on the record.

I get the impression that you both strongly feel that the no disclosure of bidders priority of award provision, as it now exists, is the appropriate way to do it?

Mr. ROTH. That is correct.

Ms. LEFTWICH. Yes, that's right.

Senator DIXON. And you don't want to change that.

Ms. LEFTWICH. We don't.

Mr. ROTH. No.

Senator DIXON. For the record, would you each make a brief statement as to why we don't want to change that.

Ms. LEFTWICH. Our position for this as for some of these provisions is it is not broken, it does not need to be fixed, and all it adds is an administrative burden. We don't see the offset in what was originally felt would be the benefit of it.

Senator DIXON. Thank you.

Mr. Roth.

Mr. ROTH. Let me speak to that from the point of view of a practitioner of procurement.

We set aside a group of procurements at each of our procurement locations, and we make those class set-asides based on prior experience. This is an automatic set-aside for small business.

If we have to publicize who we expect to bid within 5 days, it will be a Government determination that these companies will bid. Who knows—they may now have grown and become large businesses.

I see nothing but problems associated with this.

We then publicize in the CBD, the "*Commerce Business Daily,*" at which time we get a larger and a broader spectrum of folks who may be interested in our procurement. The list submitted after 5 days of a set-aside decision would be, by necessity, an incomplete list that would be furnished to whoever requested it.

I think, frankly, that it is a meaningless exercise at that stage of the game.

Senator **Dixon**. In both your cases, do you think it serves no particular useful purpose to do it?

Ms. **Leftwich**. That is correct, Senator. Yes.

Mr. **Roth**. I think it is a harmful provision.

Senator **Dixon**. I think you both have indicated that you would like to have the $25,000 small purchase threshold that is provided for in this bill.

Is that correct?

Mr. **Roth**. Yes.

Senator **Dixon**. Is that right in your case, too, Ms. Leftwich?

Ms. **Leftwich**. Yes, it is.

Senator **Dixon**. Was there a little difference of opinion between you about the question of goaling as a totality, as distinguished from by SIC codes?

You indicated that you wanted to keep it by totality?

Mr. **Roth**. That's correct.

Senator **Dixon**. What did you say, Ms. Leftwich?

Ms. **Leftwich**. We say that we would like to keep it totality, yet I guess we hedge that we recognize what section 921 was in response to.

Senator **Dixon**. Sure, that you don't want to pick on a few classifications, very frankly.

Ms. **Leftwich**. That's correct.

Senator **Dixon**. But can't you try to motivate yourself within the particular department, Defense, to try to branch out from an administrative standpoint, without having this legislative direction that is so finite that requires all this paperwork?

Ms. **Leftwich**. I think that we can. The agency's goal is always to broaden participation.

We know where there is extraordinary participation by industry and we know where there is very limited participation. But where there is very limited participation is most often a function of the lack of availability of small firms, as opposed to a particular goal in an area.

Senator **Dixon**. Now in both your cases—I don't know if I remember what your position was on 50 percent being performed by the bidder.

What is your position on that?

Ms. **Leftwich**. Our position is that we support the notion of limitations in subcontracting, again, on the simple theory that the benefits of a preference program of a small business set-aside preference program or whatever should accrue to the small firms.

We have seen a couple of "horror stories," where we have seen extraordinary subcontracting on a small business set-aside, which seems to thwart the intent of the set-aside.

We agree that there ought to be flexibility. We feel that the statute provides that flexibility to SBA to adjust the size standard, and we certainly don't feel that there should be a "drop dead" percentage, and if the percentage is 50 percent and a firm goes to 51 percent, something horrible happens.

Theoretically, we see the need for some protection in the set-aside program.

Senator DIXON. It strikes me that you are going to have to be in review of the process all the time to make these determinations. I think we'll have to put on a lot of extra people.

What do you think about it, Mr. Roth?

Mr. ROTH. Well, from a practical standpoint, I would agree with you. Also, one of the issues that we point out is that in a firm, with a fixed price, sealed bid type of procurement—and a goodly portion of our procurements are on that basis—we are concerned that we are getting a reasonable price for the Government. We are really not that interested in how a particular individual or a company performs that contract, that is, whether it is that 50 percent subcontracting or 52 percent.

Senator DIXON. Of course, we are concerned about the sham operations. That is the whole point and thrust of this, isn't it?

Mr. ROTH. I would assume so. I really don't know what is behind it, but I would assume that that is the case.

Senator DIXON. Well, you read some horror stories.

Mr. ROTH. Well, you know, one out of X number of procurements going bad does not mean that you have to then—you know——

Senator DIXON. Well, that actually is my question. Is it de minimis?

Are there a lot of cases out there of sham operations, or is it really relatively a modest number against the whole procurement policy that you deal with?

Mr. ROTH. I would assume that it must be a very modest number because the number and the times that we have exposures of this nature are few and far between.

I recognize that we are dealing in millions and millions of transactions.

Given that we are not perfect, there are bound to be problems. If there were no problems, one would then be a little bit concerned, perhaps about overstaffing.

But you have to manage at the edge or assume or be willing to accept a certain level of risk, and it would appear to me that we are well within the bounds of propriety in any kind of risks that we are facing with regard to this particular issue.

I just wonder, for instance, what would happen if the law goes into effect with the 50 percent rule and a general contractor with the Department of Defense builds something at some military base with subcontractors, and later one of his competitors in town writes and says I can prove that he ended up using subcontractors for 58 percent of the work, and so forth.

What happens then to that individual? I presume it was done innocently—I don't know whether you pay that much attention to what percentage of a total contract the plumber and the electrician and the painter and the plasterer and all the different parts of a construction job actually comprise. What would you do then?

Ms. LEFTWICH. It is interesting because construction is one of the industries that I don't think should be subject to the 50 percent rule because our understanding is that, by general industry practices, it is a subcontracting market by definition.

Senator DIXON. It's not accepted, is it?

Ms. LEFTWICH. It is not accepted other than when industry practices dictate otherwise. So we would argue that the SBA has the jurisdiction to look at the construction percentage specifically, for what is compatible with industry practices.

Senator DIXON. I'm told that SBA could do something about it, but they are not going to if the law stays as it is.

Ms. LEFTWICH. Again, I would defer to the SBA, which has the authority to look at that particular industry, and would suggest that experience does show that you have a different market, which requires different consideration.

As you know, the subcontracting percentages are in effect for the 8(a) Program, as of right now. So, in effect, we would be essentially bringing the Set-Aside Program into sync with the 8(a) Program requirements there.

Senator DIXON. Would both of you tell me if there is anything in this bill that we ought to be taking out, which bothers you?

Ms. LEFTWICH. There is one thing I would like to clarify.

Going back to your question of whether we agree with the $25,000 threshold, I probably misunderstood if you meant do we agree with goaling only over $25,000. As we stated before, DOD is probably in a unique situation, in terms of the data that we have, to be able to goal under $25,000, and we feel that that is important.

So we agree with the goaling down to zero dollars. That was the only clarification that I would make.

Senator DIXON. And you, Mr. Roth?

Mr. ROTH. We disagree with it. I will again put my GS-9, GS-11 or GS-12 procurement practitioner hat on and say that this is just another added item that we must enter into a data system which is of absolutely no use to the practitioners, who I believe happen to be overworked, in their present day-to-day operations.

The idea that you are goaling down to zero also means that you must track down to that level, with the added millions of data items that we will be entering into these systems, which would serve no practical use for the procurement community whatsoever.

Senator DIXON. Well, won't there be more small business participation also if you set aside all $25,000 and under?

Mr. ROTH. It would appear to me that any time we do not use a small business for the set-aside, which will be the new $25,000 threshold we have to justify it. So, therefore, my natural inclination is to go with the easiest way of doing it and get some of these procurements out the door. One would, therefore, go with small business in every case, unless there just is not small business availability.

Senator DIXON. I want to thank you both for your cooperation.

We have some written questions here. If you would indulge me, I will send those along and would appreciate, as early as you can respond to them, your answers.

Ms. LEFTWICH. Thank you, Senator. Certainly.

Mr. ROTH. Yes. Thank you.

Senator DIXON. Thank you both, Ms. Leftwich and Mr. Roth.

Next we will hear from Panel II, consisting of Karen Hastie Williams, former Administrator of the Office of Federal Procurement Policy, and Jack Rennie, president of Pacer System, Inc., representing the National Small Business United Organization.

Good morning.

I assure you both that I have read your remarks in full. To the extent that you can abbreviate them to save us time, so that we can get to our questions, I would appreciate it.

Ms. Williams.

STATEMENT OF KAREN HASTIE WILLIAMS, ESQ., CROWELL & MORING, WASHINGTON, DC, FORMER ADMINISTRATOR, OFFICE OF FEDERAL PROCUREMENT POLICY

Ms. WILLIAMS. Thank you very much, Mr. Chairman.

I appreciate your including my entire testimony in the record, and I will summarize in the interest of time.

Senator DIXON. Thank you.

It will be included.

I might say that your statement was rather lengthy, and I do want to assure you, Ms. Williams, that I have read it in full.

Ms. WILLIAMS. Thank you, Mr. Chairman.

Let me say at the outset that I endorse enthusiastically the concept of fair proportion as the guidance for small business participation in the Federal marketplace.

I have long believed, based on my experience within the Government and in the private sector, that it is in the interest of the Federal Government and the private sector to provide opportunities for small businesses to expand their participation in all aspects of the Federal marketplace.

Focusing on the fair proportion concept permits SBA, the contracting agencies, and industry to concentrate scarce resources and special mechanisms on those industries in which small businesses have not enjoyed extensive participation, and to let the market forces of open competition set the appropriate level of small business participation in those industries in which small business activity has traditionally been high.

Over the past several years, numerous mechanisms have been used by the Congress to encourage Federal agencies and prime contractors to reach out to small businesses. Some have been more successful than others.

For example, the implementation of set-aside goals by many agencies has evolved into simply a mechanistic numbers game. Many agencies have lost sight of the true objective of expanding procurement opportunities to achieve fair proportion participation by small businesses.

This Committee is uniquely qualified to examine small business participation in the Federal marketplace from a broad perspective, without bias or vested interests. With a goal of maximizing the participation of small business in Federal contracts and increasing the Federal dollars flowing into the small business economy, this Committee has the opportunity to fashion some novel mechanisms to implement the sound goals of section 921.

As you have seen in my written testimony, I have made some comments about the initial intent of section 921. I have also commented on the impact of the report from the Small Business Administration and highlighted some of the practical implementation problems that you have been discussing with the agency representatives this morning. I have also offered some suggestions as to additional mechanisms that this Committee might explore.

In the interest of time, I would like to elaborate on my suggestions for a pilot program, which I believe may get to the hub of the problem in those industries, where you have a concentration of small businesses.

I think, as Ms. Harrison commented this morning, adjustments of the size standards through a very complicated mechanism on a regular basis is administratively going to be very difficult for the agencies to administer and for SBA to implement.

I would commend to the subcommittee the exploration of a Pilot Program that would test several innovative procurement procedures. First, it would expand the concept of small business participation to include both open competition, set-asides under section 15, minority set-asides, both under section 8(a) and the 5 percent goal at the Defense Department and any other set-asides authorised by law, as well as subcontracting. Next, it would focus the 30 percent small business participation goal on each reporting agency. Finally, it would utilize product and service codes as the appropriate measure of participation. Goals could be achieved either through open competition, or, if the goal were not achieved, the use of specialized tools, such as the set-asides would be permissible.

From an agency perspective, I think this would greatly simplify the process and would result in the agencies being more cooperative and focusing on implementing the section 921 fair proportion goal.

Control would be at the reporting agency level. As Mr. Roth emphasized this morning, from the standpoint of the practitioner, this is where the small business opportunities get identified and actually get implemented.

Second, from the perspective of the contracting community, opportunities, I believe, would open up for greater small business participation through a combination of open competition and the special mechanisms. Prime contractors would be encouraged and they could be incentivized to use more subcontracting with small businesses.

Nothing in this Pilot Program would preclude small businesses from winning 100 percent of all contracts awarded by a reporting agency in open competition. I believe use of this Pilot Program would test the market for small business participation in those industries that are dominated by small businesses. It would serve the interests of the Government, the industry, and the small business community.

I believe the experience of the Department of Defense, with the threshold program for the architectural and engineering community, is instinctive on how a program of this kind could be implemented also on a governmentwide basis.

I believe that the implementation of section 921 currently must be viewed in the perspective of the entire small business program. It does not proceed in a vacuum.

As a practical matter, the contracting officer is confronted with cases where the agency must look at both the ceiling of 30 percent, as well as the requirements under the Rule of Two for setting aside small business opportunities.

While the SBA and the agencies have initiated efforts to implement section 921 on the October 1 date which is currently mandated by law, I have no doubt that they are struggling with the overlay of the fair proportion concept, changing size standard provisions, and the set-aside requirements of the Rule of Two.

I would hope this subcommittee would consider moving forward with some of the technical changes that have been recommended in S. 1559, and would move to look at a Pilot Program that could use these for industries, initially identified by the Congress as having concentration's of small businesses, to go forward with an experiment. Congress can look at what happens when a program based on small business participation broadly defined is initiated, and see how that works in those four industries.

I think that a mechanism of this kind will simplify the process, will lead to encouragement and active support by the contracting officials themselves, who have the responsibility for implementing these programs. In reviewing the reports and the interviews that the Small Business Administration conducted, it seemed evident to me that the contracting officers, from a very pragmatic standpoint, even though they sought to support the Federal policy, had real problems from an administrative standpoint in going forward with the implementation of section 921.

To summarize, I would expand the definition of small business participation. I would measure the awards according to the product and service codes of the FPDS. I would look for each agency to have a 30 percent reporting goal for each product and service code. I would achieve these goals through a combination of open, competition supplemented with specialized tools in the event that the annual goal is not reached the previous year.

Mr. Chairman, I would be happy to respond to any questions that you may have.

Thank you for the opportunity to participate.

[The prepared statement of Ms. Williams follows:]

CROWELL & MORING

STATEMENT OF
KAREN HASTIE WILLIAMS

Before the

United States Senate Committee on Small Business
Subcommittee on Government Contracting and Paperwork Reduction

September 21, 1987

CROWELL & MORING

Mr. Chairman and Members of the Committee:

My name is Karen Hastie Williams. I am a partner in the law firm of Crowell & Moring and former Administrator of the Office of Federal Procurement Policy in the Office of Management and Budget. As a private practitioner, I have counseled companies with diverse interests--small and large businesses, construction and architectural and engineering firms, computer and system design companies and minority businesses--in connection with their participation in the federal contracts marketplace. As a government administrator, I attempted to enforce the goaling provisions of Public Law 95.507 and negotiate goals with the three largest agencies.

I endorse enthusiastically the concept of fair proportion as guidance, embodied in Section 921 of Public Law 99-661, for small business participation. I have long believed that it is in the interest of the federal government and the private sector to provide opportunities for small businesses to expand their participation in the federal marketplace. Focusing on the fair proportion concept permits SBA, the agencies contracting and industry to concentrate resources on those industries in which small businesses have not enjoyed significant participation and to let the market forces of open competition set the level of small business participation in those industries in which small business activity has traditionally been high.

Over the past several years, numerous mechanisms have been used to encourage federal agencies and prime contractors to reach out to small businesses. Some have been more successful than others.

This Committee is uniquely qualified to examine small business participation in the federal marketplace from a broad perspective without bias or vested interests. With a goal of maximizing the participation of small businesses in federal contracts and increasing the federal dollars flowing into the small business economy, this Committee has the opportunity to fashion some novel mechanisms to implement the sound goals of Section 921.

This morning I would like to review briefly the language of Section 921, then turn to the impact of the Report of the Small Business Administration on the size standards generally and to the industries identified in Section 921. Then I will examine some of the practical implementation problems that arise in fulfilling the mandate of § 921 and suggest some alternatives that may help to achieve the objective of a fair proportion of small business participation in the federal procurement process.

In summary, my testimony concludes that it would be prudent for the Committee to move forward with the principle of fair proportion, to pursue the mechanisms established by Section 921 to reduce size standards where more than 30% set-aside occur, but also to pursue on an experimental basis an alternative strategy in a pilot program aimed at industries with high concentrations of small businesses.

In my view, a pilot program should include the following elements:

- Definition of "small business participation" to include open competition, set-asides under Section 15, minority set-asides, and subcontracting.
- 30% small business participation goal for each reporting entity.
- Goal can be achieved through open competition or, if that is not the case based on the previous year's history, through open competition and a combination of specialized tools.

  Specialized tools include:

  - awards to small business through set-asides under Section 8;
  - awards to disadvantaged businesses through other than full and open competition--*e.g.*, 8(a); 5% set-aside of *Public* Law 99-661 and any other specially targeted programs; and
  - subcontracts.

From the agency perspective, this procedure is greatly simplified compared to the current mechanisms to lower size standard by SBA and the agencies under Section 921. Control would be kept within the reporting entity, the organizational level most familiar with opportunities for small business participation. From the perspective of the contractors, the opportunities for small business participation through a combination of open competition and special mechanisms would be demonstrated by contract awards under this system. Nothing in the pilot program would preclude small businesses from winning 100% of all contracts awarded by reporting entity in open competition.

The pilot program could test the market for small business participation in the § 921 industries, all of which are dominated by small businesses. Use of this pilot approach would serve the interest of the Government, industry, and small businesses. The experience of the Defense Department with the threshold program for the architectural and engineering community could be realized on a government-wide basis.

From the perspective of small businesses, the expansion of small business participation to include a fuller range of contracting opportunities will enhance the likelihood that more federal procurement dollars will be flowing into the small business community.

I would like now to respond to the Committee's request for my assessment of the impact of Section 921 on small, disadvantaged business participation in the federal procurement marketplace. I would then like to comment on the proposed amendments by Senator Dixon in S.1559 and finally pose some alternate some alternative suggestions pertaining to small business participation through open competition and specialized tools such as the set-aside programs.

I. Background

In 1986, Congress enacted legislation to reform the set-aside program for small businesses with the enactment of Section 921 of the Defense Acquisition Improvement Act of 1986 (P.L. 99-661).[1] While some controversy continues to exist with respect to the origin of these provisions, it is clear that Congress intended for these reforms to provide assistance to truly small businesses and to enhance the environment for all size firms to compete for federal contracts. Set-asides are intended to protect truly small and entry-level businesses. Evidence submitted to the Congress last year and again this year clearly supports the fact that there is a direct correlation between size standards and excessive set-asides in certain industries--especially those dominated by small businesses.

Congress directed the Small Business Administration (SBA) to make an initial examination of the size standards in four impacted industry categories: architecture and engineering (including surveying and mapping), shipbuilding, construction (including dredging), and refuse systems. SBA was instructed to report back to the Small Business Committees by July 15, 1987. In the report, the SBA was directed to address only the implementation of the revised set-aside/size standard procedures in § 921. It was to look at the implementation from the SBA perspective and to include comments from the agencies and the public. The report has now been delivered to the Hill. Copies of the Executive Summaries have been made available to me and other witnesses. I have also reviewed the entire report.

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[1] Virtually identical language had also been added as amendments to the Small Business Act and included in the Continuing Appropriations Resolution (P.L. 99-591).

The SBA report concludes that it is advisable and feasible to implement Section 921 with the exception of the requirement in § 921(e) to disclose the list of potential small business bidders at the time that a set-aside decision is made. SBA believes, and I concur, that the administrative burden of compliance with this requirement is far greater than any benefit to be gained from early identification of potential "sham" organization.

On the special review of the four industry groups identified in the statute (which comprise 29 separate SIC codes), the report makes an initial finding that the 30% set-aside level was not exceeded in shipbuilding and ship repair (8%); architecture and engineering (16.1%); refuse systems (23%); or heavy construction NEC (20.9%), including dredging (16.6%).

The results indicate that SBA will propose new size standards for the construction industries (except heavy construction NEC) and land surveying.

In addition to preparing the July 15 report, the SBA is working with industry and the federal agencies to develop a methodology for accumulating data and information to support a regular review of all the size standards and further implementation of the set-aside procedures required by § 921. Even as this process moves forward, it would be advisable for members of Congress, agency and industry representatives to cooperatively examine additional mechanisms to enhance small business participation in federal procurement.

The SBA report and the comments from agencies and industry sound a consistent theme of support for application of the fair proportion concept to small business participation. I encourage the Committee to concur in support for the fair proportion concept and to use this concept as a tool to marshall the operational resources of the government.

II. § 921 provides only one response to excessive set-asides.

It is critical, however, for Congress to examine the small business incentive programs in a broader context than just § 921. When Congress amended the Small Business Act and passed § 921 last year, it established a statutory foundation for the process of re-determining small business size-standards and linking size-standards to the process of set-asides under Federal contracts. The new legislation seeks to ensure that a fair proportion of total government contract dollars in each industry category are awarded to small business concerns. To this end, it defines "industry category" in relation to the appropriate SIC code and permits further breakdown within a SIC category under appropriate conditions.

While the goal of linking industry category to SIC Codes is theoretically sound, it creates administrative heartburn for the contractor and the federal contracting agency. Procurement data is not maintained on a SIC code basis. It is virtually impossible for a contracting activity to maintain separate, multiple goals for thousands of SIC Codes.

Section 921 also provides for the SBA to review current size standards in four specifically designated industries. Further periodic reviews of these and other size standards are also required to maintain an appropriate balance between contracts awarded under open competition and contracts awarded under set-aside awards. The procedure for review is cumbersome.

Under the 1986 legislation, the balance is determined by review of contract volume on a government-wide basis--not an agency basis. If set-aside awards to small business in any SIC code industry category exceed 30% of the total contract volume, then the SBA Administrator must consider reduction in the size standard.

Data on awards from the agencies cannot reasonably be readily verified. Although any proposed change in the size standard must be published in the Federal Register and made available for public comment prior to final issuance, in fact little changes are likely to occur.

Section 921 also contains several other key features that set-aside contracts may not be awarded if the costs to the agency exceed a "fair market price". Moreover, a small business is required to perform at least 50% of the work under the contract in order to retain a set-aside award under § 921. Under circumstances where a decision is made to set aside a requirement, the legislation requires the contracting officer to disclose information on expected small business bidders.

The drafters intended for these reforms to eliminate "sham" firms. However, the time bottle neck is likely to hinder the opportunities for small business to participate in a wider range of Federal contracts on an industry-by-industry basis.

III. Implementation Problem Areas

Despite the apparent advances in 1986, full implementation of the fair proportion requirement of § 921 is at odds with the existing agency interpretation of the "Rule of Two", FAR 19.502.2. At the present time, the Rule of Two mandates that all requirements be set aside when two or more responsible offerors are expected to submit bids or proposals. Nothing in the current rule would halt this process after an agency reached a 30% set-aside level.

The Rule of Two is inconsistent with the fair proportion standard. The FAR requirement for civilian and defense (except for special A-E treatment provided in P.L. 98-407) agencies remains in place and undermines the 1986 legislative reforms. Under the FAR provision, a contracting officer (CO) must still set aside a contract for small business, if there is a reasonable expectation that two or more companies will submit bids or proposals at reasonable prices. In all four of the industries identified in § 921, the CO is torn between the regulatory mandate to set aside and the knowledge that exceeding 30% set-asides will contribute to lowering size standards in the future.

As a practical matter, a contracting officer is confronted with cases where award will take the agency over the ceiling but he/she has no knowledge of the impact on a government-wide basis. Therefore, he goes forward with a set-aside to assist in meeting the agency's small business goals under P.L. 95-507. This procedure undermines the ability of the SBA to control excessive set-asides and undermines the opportunities for meeting the fair proportion objective within key agencies.

Moreover, while SBA and the agencies have initiated efforts to implement the changes mandated by Section 921 and to integrate them into other procurement-related procedures, the overlay of the fair-proportion/size standard provisions and set-aside requirement provisions on the "Rule of Two" (FAR 19.502.2) continue to spawn difficulties. Several of the implementation problem areas are highlighted below to demonstrate some of the pragmatic impediments to realization of the fair proportion objective.

- Government-wide linking of "fair proportion" to 30% of the dollar value of only set-asides--"8(a) and 15(a) contract awards"--for each "SIC industry category" creates an administrative dilemma for the agencies, SBA and multiple business barriers for many firms.
    - SBA must rely completely on the agencies to report the awards made by each agency in order to compile the government-wide statistical impact.
    - Without the agency data, neither the SBA nor the public can determine the validity of a size standard or a proposed change in a size standard.
    - Failure to examine comprehensively all small business awards distorts the efforts made by each agency to maximize small business participation and to reflect the true volume of small business participation.

The § 921 provision that limits to set-asides the measure of small business participation provides only one perspective on the federal marketplace. Agencies, industries and the SBA would be well served by considering several corrective measures. First, expansion of the base of participation to include all federal dollars flowing into the small businesses through open competition, set-asides, and subcontracts would enhance small business participation.

The picture painted would more accurately reflect the level of activity. It would also provide an incentive to agencies with less attractive records of goal achievement and permit them to obtain recognition for the full range of procurement activities that deliver dollars into the small business community.

Goals under § 921 or any alternative provision should be focused on agency-contracting activity level. Knowledge of the goods and services and the market for those goods is lodged in that agency. Focus of goods on an agency-by-agency basis will allow small businesses to target low performing agencies and enhance the opportunities for enforcement of the goal--whether under the 30% set-asides rubric or the 30% small business participation pilot program.

It is clear that in determining percentages, all awards (except small purchases) should be considered, i.e., awards to small businesses under open competition, set-asides--e.g., 8(a), (15), P.L. 99-661 and other specially targeted programs--and subcontracts.

SIC codes are not presently included in the Federal Procurement Center data base for contract awards. Agencies could easily track awards by product and service codes as now used by the FPDC to monitor contracting activity by agency.[1] Product and service codes provide a more accurate, pre-existing industry measure for monitoring procurement awards. A look at the 1986 figures for over 1,750 different industry groups reveals some

TABLE 1

PRODUCT AND SERVICE CODE -- FY 1986 CONTRACT ACTIONS

(Codes With Over 25 Initial Procurement Actions)

(In $000)

% Set-Aside	Total Procurement	Set-Asides and 8(a)	Average	Number of Codes
70-100	3,024,072	2,215,877	73%	46
50-70	3,724,695	2,049,524	55%	49
30-50	7,866,411	2,861,560	36%	92
10-30	17,568,239	3,078,042	18%	179
0-10	109,795,579	2,824,411	3%	279
Total	141,978,996	13,029,414	9%	645
Total--All Codes FY 1986	182,558,799	14,638,321	8%	1,759

Source: Federal Procurement Data System -
Fiscal Year 1986 - PSC Awards

interesting results. For example, Table 1 shows that among all the Codes, 46 categories carried set-aside and 8(a) awards in the 70-100% range with an average of 73% and total procurement value of $3.0 billion. By comparison, 279 categories carried set-aside and 8(a) awards in the 0-10% range with an average of 3% and total procurement value of $109.8 billion. These statistics confirm the view that the Congress should utilize the fair proportion concept as a means to prioritize the use of set-aside programs in industries with low small business participation levels.

IV. Dixon Bill, S.1559 proposes some useful corrections.

A. Description

Senator Dixon's bill, S.1559, proposes to correct certain flaws in Section 921. The Dixon bill proposes to replace the fair proportion measure of each "SIC industry category" with "total awards within a Federal Stock Classification". It replaces the "fair market price" limitation with a more ambiguous "fair and reasonable price" standard.

S.1559 also establishes a $25,000.00 threshold in establishing goals for participation by small businesses and hence measurement of percentage of set-asides in each industry classification. The Dixon proposal substitutes a "best efforts" requirement for the 50% mandate for prime performance. It also repeals the language with respect to the contracting officer's obligation to disclose information on bids early in the process.

B. Analysis

By deleting all language defining "industry category" or relating to "SIC codes", the Dixon bill, to some extent, simplifies the administrative responsibilities for accumulating data because DOD currently uses the Federal Stock Classification Number. But, this simplification is an illusory benefit. The change eliminates an industry-related standard as the basis for data accumulation and basis for determining a fair proportion of procurement awards. No clear reading on market concentration will be feasible from review of stock number data. Services which constitute a key opportunity for small businesses are not ordinarily monitored by stock numbers.

The use of a "fair and reasonable" price standard is ambiguous and may lead to additional, unwarranted payments under the set-aside program. The existence of multiple terms related to price within the small business set-aside programs will only cause confusion. Most contracting officers will interpret the terms "fair market price" or "fair and reasonable price" or "reasonable price" using the same standards of measurement. First, they will assume that competition in the market produces a fair price. If they have any question, they will look to a price analysis. If doubt still persists, they will conduct a cost analysis. These three basic steps generally will guide any responsible contracting officer in evaluating a fair price.

Elimination of small purchases under $25,000.00 in the agency's small business set-aside goal, has the impact of a de facto rise in the agency's goal without any recognition of the efforts to direct other federal dollar actions into the small businesses coffers. This proposal could be enhanced to broaden the measure of small business participation by including contracts awarded to small business in open competition and subcontracting.

The Dixon bill substitutes a "best efforts" standard for the mandatory 50% performance requirement of § 921. The current standard of 50% is unworkable in many industries. For example, construction procurements need many specialized subcontractors. High technology systems and development contractors often team or subcontract with other small businesses to fully satisfy customer needs.

The "self-policing" mechanisms of the existing legislation are destroyed by the Dixon proposal to repeal the information disclosure requirement. A more appropriate change might more likely focus on delayed timing of the disclosures until after bid closing or proposal submission date.

V. Alternative Strategies to Enhance Small Business Participation

A. Further refinement to the § 921 size standard reduction and set-aside procedures through amendments similar to the Dixon bill. Key features of any amendment should consider the following elements:

1. Measure industry category by product and service codes as proper classification tool. This is a far more comprehensive industry identification tool than the stock numbers and is already the standard used by the procurement process to monitor procurements. 1986 data show major concentration of industries at 73% level.

2. Measure industry performance by agency rather than on a government-wide basis for the industry:

- Simplifies the data collection process and assures the accuracy and verifiability of the data;
- Reduces the potential antagonism among agencies with respect to participation in a program.
- Prods the contracting officers, competition advocates and small business advocates into a more aggressive procurement program for small businesses.
- Increases the likelihood that each agency will diligently seek to balance the procurements within its agency among set-asides and open competition rather than assuming "another agency will cover this."

- Refines the triggering mechanism to an agency-by-agency basis to enhance the opportunities for open competition.

3. Change 50% performance to "best efforts" requirement in order to avoid excluding small business joint ventures and other situations which require subcontracting to specialty firms.

4. Consider removing $25,000.00 threshold for goals. Provide for maximum participation in § 921 of all small businesses, including open competition, 99-661 and set-aside tools.

B. Establishment of a dollar volume threshold for each product and service code.

1. Specifies dollar volume below which all procurements will be set aside for small businesses.

2. Supports consistent treatment on a government-wide basis by application of the dollar threshold for each product and service code in both military and civilian agencies;

3. Simplifies the administrative burden;

4. Experience of the Defense Department with the $85,000.00 threshold level for architectural and engineering firms is informative. Numbers and dollar volume of contracts awarded under set-asides have fallen dramatically. Yet, the relative dollar volume and percentage of contracts won by small businesses remains relatively constant. Result of the industry structure that permits effective competition without set-asides.

5. Consistent with recommendation in SBA report.

C. Establish a pilot program.

Another alternative would be for the Congress to reflect ongoing concerns about these four industries through establishment of an experimental, pilot program to test the level of concentration in any given agency.

To achieve this objective, several bold steps would need to be taken.

- Expand "small business participation" to include all awards to small businesses--through open competition, set-asides, subcontracting;
- Measure awards using product service codes;
- 30% goal for each reporting entity's small business participation program;
- Achieve goals through combination of open

competition and specialized tools;

- 1-year backward snapshot of data.
- Use of prior year's data to measure actual participation levels. If open competition levels high, other specialized tools are used to meet the goal. Closer in time and efforts to performance.

All of these alternative strategies suggest modest amendments to S 921, including several fashioned after the Dixon Bill. Any of the proposed alternatives would add significant pragmatic impact, incentives, and simplicity to the SBA set-aside program.

Thank you for the opportunity to testify this morning. I am prepared to respond to any questions from the Committee.

* * *

Senator DIXON. Thank you, Ms. Williams.

We will hear next from Mr. Rennie, and then will ask you both questions.

STATEMENT OF JOHN C. RENNIE, PRESIDENT, PACER SYSTEMS, INC., BILLERICA, MA., REPRESENTING THE NATIONAL SMALL BUSINESS UNITED [NSBU]

Mr. RENNIE. Thank you, Mr. Chairman.

I am certainly pleased to have an opportunity to testify today and I would also ask that my remarks be entered into the record. I know they are long, so I purposely will summarize them for this morning's session.

Senator DIXON. Thank you, and I assure you that I have read them.

Mr. RENNIE. The comments include some general remarks which I felt were important by way of setting a stage or setting a sort of envelope within which the other comments are presented. I do comment specifically on the P.L. 99-661 amendments to the Small Business Act, S. 1559, and here and there in passing on the SBA report, which I had a chance to review as well.

I am representing National Small Business United today, a national, all-industry association, with about 40,000 member companies.

I also have about 30 years of experience in Federal procurement, 10 of it on the Government side of the fence, as a naval officer, test pilot, program manager in the research and development, test and evaluation sphere, and in the last 20 years in developing my own company. Most recently—and I think it was helpful in preparing these remarks—I was the Commissioner for the Procurement Issue Area of the White House Conference on Small Business in 1986.

Preceding my specific remarks, I had some general comments which I think reflect our view of the sort of state of the procurement system from the practitioner-operating level.

We pointed out four areas of over-riding concern, which we feel contribute to what we currently perceive to be a very strained and confused situation.

There is a considerable amount, certainly in my recollection, of more misunderstanding and mistrust between the people in the industries and on the Government side of the fence than I ever can recall.

There is a major procurement flaw. I have testified about it before. I usually take any opportunity that I can to mention it. You can just use the old analogy of it being sort of the disease which causes a lot of the symptoms which P.L. 99-661 addressed, and now we are trying to fix that, and it causes all kinds of aberrations in the system, and that is that there is basically a disconnect that has occurred between the people in the Government, well-meaning civil servants, with responsibilities for program management, getting on with the job on a calendar basis, and the flow of contracting paperwork, which is totally disconnected from them.

So, if I sit here in September, as a program manager, and I have a major review, milestone, or something to achieve next September, there is no way that I can complete the work that I need to get there because I can't even complete a competition by next September. That disconnect causes all kinds of well-meaning people in the government to get the job done in whatever way they have to.

From this we see things like larger procurements, multi-year procurements, more use of IQCs. This leads to less competition and ultimately to less meaningful participation by small business.

So many, many of what I call the "symptoms" are the things that we try to fix all the time. And yet, I think from my perspective very little has been done to address what I think is the major flaw and an important disconnect in the whole system.

The third area I think is the failure of all of us to address elemental questions in the system regarding the system itself. There are still many barriers to entry for small business for a variety of reasons. The knowledge of requirements is too late and not fluid enough.

The SIC code system, as I mentioned in my testimony several times—as you probably recall—is totally, totally useless when it comes to procurement. It already has been referred to here once this morning in I think the testimony of the Department of Energy, that some aspects of using SIC codes are totally useless.

I will comment on that later. But the important thing is that the SIC code system was set up and is run for the purpose of economists, for inputs to econometric models and things of that nature.

When one starts talking about, you say well, why don't we just have more SIC codes so that we can describe things better. Well, it is not that easy to change the SIC code system.

We have a major procurement activity here at $200 billion a year. We still insist on using the SIC code system, and that is the source of many of the problems that SBA has in setting size standards, and so on.

Another fourth point of major significance, and especially true as the system becomes more, let's say, confused, is that the people in the system, outside the Beltway here in Washingon, become much more nervous than they would in a stable time. Any time there are changes that are rumored, legislation that is going to change, regulations that are going to change, all of these things cause the pendulum to swing dramatically more outside the area of Washington than it does in Washington.

At the end of my brief testimony, I am going to cite an example of a program that my company is in right now, which will show, in a sense, how confused things are and how people overreact to things that have not even happened yet, in some cases.

Now, with respect to my specific comments on the P.L. 99-661 amendments, I agreed with the SBA conclusions regarding the fair market price versus fair and reasonable price. Actually, I did not dwell on it too long. I concluded actually that they were essentially the same in intent.

I also noted that the contracting officer's ability to determine a fair price, whatever we call it, depends on the specificity of the requirement. In other words, if a requirement is very well defined—we have a stack of drawings, we have a whole set of specs and things and those are all available to the potential bidders—then the contracting officer can use past procurements; he can even, in fact, use the bids that come in to almost determine if someone is out of reasonable range.

The less defined, however, the requirement is, and this is true in many cases in research and development areas, service, professional services, for example, where, in essence, the Government is hiring the contractor in many cases to scope what it is the problem is or what is needed, then it is much more difficult for the contracting officer to determine a fair price.

On the other hand, in those types of procurements, quality and those types of factors, non-monetary factors, should have a much higher weighting in any case so differences, small differences, in interpretation of price probably are not that important.

But, generally, the way it hit me was frankly a fair market price from the contractor is a fair market cost to the buyer, and there are differences in the regulation and legislation.

I took it, as you indicated, that the intent was basically the same.

With respect to the 50 percent rule, I have much to talk about there.

I agreed with the COC specialist from SBA in that particular part of the report. I happen to feel that it will have a chilling effect on the Small Business Set-Aside Program, especially for larger growth jobs.

The initial reaction in the small business community to something like this is well, this is a good deal and we will do more work and things of that nature. But the whole system looks at it a little differently. The Rule of Two provides that a contracting officer first, when looking at a requirement, has to decide that he has two or more responsible small businesses. If he looks at a larger job, he may come to the conclusion that well, I could set it aside if they could team with a lot of companies and augment their own capabilities; but now, where they have to do 50 percent of the work, I am not sure that I can get a responsible small company, and he would not set it aside.

I see that especially in the larger kind of, what I call the growth jobs, those sort of larger procurements that companies go along in the Set-Aside Program and then these are the things that allow them to make a step up to a much higher level, let's say, as they are growing.

Those are the very interesting jobs which have real potential and could be cut out of the program.

This is made especially bad by the fact that I have talked to the counsel on the House Armed Services Committee, who largely drafted this provision. Their interpretation of the 50 percent rule is if we are talking about an indefinite quantity contract, delivery orders with various tasks, and so forth, or similar contracts of that type—sometimes a BOA could be included in that—then their interpretation of the 50 percent rule is that each task as it is funded is considered a separate contract, even though it is done under an umbrella contract.

Therefore, the 50 percent rule applies to each task.

Now, when you get to a large IQC, or even not too huge an IQC, quite often there are a number of different talents or discipline areas that are required. What happens is this. Companies, in order to credibly bid, even small companies, and large companies for that matter, some have to bring in team members with expertise that they do not have.

You can see that with the 50 percent rule applying to every task, we now have a case of where not only does the prime have to do 50 percent of all the work in a total way, but now has to do 50 percent of every task, the disciplines for which they most likely do not have.

Furthermore, you have large companies or small companies with talents as subcontractors, where nothing will show as their work, and basically they will have to do "half the work" and hand it to the prime contractor to finish it off for the last half. I am simplifying, of course, but basically that is the kind of procedure there. It makes the whole thing even worse.

Let me hasten to say that I think the elimination of front companies, the shams, as you point out, we, of course, agree with that in theory very, very much. I have suggested three alternative approaches which, although they need more study, I think are more workable.

Basically, first, it is simply to reduce the percentage to a more reasonable percent. Second is to allow certifiably unaffiliated small firms to do 50 percent of the work or more, and that would satisfy the requirement. The third is to lower the size of the job that the 50 percent rule would apply to, so that it would be more credible that a small company could do 50 percent of the work, even if they had to hire some people, and so forth, and go from there.

Just responding to the last go-around in testimony, my experience is that this is not really de minimis, and, in fact, is probably increasing, especially as the Government becomes more sensitive to set-asides, the proposed set-asides, and so forth.

Many of the occurrences I have seen this happen in are where a big company has been doing work in a certain area. That area's work now becomes set aside by the agency for small business. The big company now has lost this market, or this mini-market, if you will, on which they have been working for some time. And, so as to keep in that market and not lose their situation completely, they find a small business to front for them, essentially, and then they do a lot of the subcontracting work.

I think that in recent years, the occurrences of this happening, although they may not always be detected or even objected to, for that matter, by the agencies, I think it does happen, and I think it would be worthwhile to have some provision to do it. I just do not think that the 50 percent rule, as it is written, does it.

With respect to goaling, I think that the goaling, as an overall approach, is good because it keeps in front of the agencies all the time, the consciousness that they should be thinking in terms of steering certain amounts of work to the small business community and other subsets of small business.

I have problems with the 5 percent goal for the small, disadvantaged businesses, as I felt it was too high in one jump; that if it had been ramped up—and I know it was stated as a goal, but as someone described to me in one of the contracting activities, it was a goal, but, boy, we were really serious about it. They took it to be much more than just a goal.

So, as a result, the agencies began to wrestle with how do we channel this amount of money, which is a sizable amount—by my reckoning, it was probably something like $8 billion—and I don't think there are any actual statistics as to how many dollars have been going to this subset of businesses before because it is somewhat of a new classification.

I remember during the White House Conference there was some talk about it. What sticks in my mind is something probably on the order of $3 billion, maybe $4 billion at most, that might have gone to that type of company, and these are in discussions.

As a result, the agencies quickly reckoned, I think as quickly as they normally could, that they were not going to get there from here with their current contracting regulations.

So that is what spawned the small disadvantaged set-aside mechanism, which I think is principally a mechanism to move funds.

I think the SDB Set-Aside is a negative development and, again, consider the overall picture of the confusion because I think, first, it will complicate the contracting officer's job quite a bit. Now, before he even would get into this, the Small Business Set-Aside Program in general, he would have to get into the SDB Set-Aside Programs. It is likely to engender abuse because of several characteristics that are proposed in the interim rule.

There is a self-certification aspect to it. The data are difficult to track. There would be confusion among other small business programs that are ongoing, not the least in importance of which would be the 8(a) Program. Also, I think from the small business viewpoint, this whole proposal that the DOD is proposing, to essentially put the interim rule into effect—as a matter of fact, the Navy has already begun to operate this way, even before the public comments were in on the interim rule—even though in the notice in the "Federal Register," they even acknowledged that there was likely to be adverse effect on the small business community in general, it just to me flies in the face of the Regulatory Flexibility Act. I mean, that was the whole purpose of the act.

Their reasoning was that we have a second interim rule coming out soon that also might have adverse impact, so we'll put this into effect in the meanwhile, and then we'll do a small business impact study after both rules are out.

My feeling is that the interim rule should be stopped, and on implementation, the Navy should be told to stop implementing it until the Small Business Impact Statement is done, or the analysis is done, and then what form the final rule would take.

With regard to fair proportion by SIC, I think that I can lend a little light on this. I have written it in my testimony.

I think this arose, really—although it may have been kicked around before—in a concrete way during the White House Conference last year. The intent here was simply to discourage a category, or let's say an informal practice which a number of companies brought up during the conference called, among the small business community, "corralling." What this basically is is that an agency would put all of their small business set-aside work in one area. As a matter of fact, to let Defense off the hook for the moment, the one I remember in particular that was brought up by several companies was the National Institutes of Health, where they would take one area, one of the national institutes, and they would put essentially all their small business set-aside work in that area. The others were largely roped off, then, and went all to universities, other contractors, and grantees.

So, that was the underlying idea of it, to simply try to spread the work around across all the work of the agencies.

The problem, as it came out, is it was translated to SIC codes again. The problems of compliance in the agencies—I think their complaints were correct because the SIC spectrum is just too large, especially when the whole notion of SIC codes are not broken down.

But I think that the idea of fair proportion is good. It needs another look. It just simply needs to be looked at in much more detail than it has been.

With regard to the codification of using the SIC system for size standards, it is probably clear from my comments that we strongly disagree with codification of this. They are being used now. My feeling is that we desperately need another system altogether.

I do not agree, therefore, that they should be codified.

On the listing of set-aside bid candidates, again, I feel this came out of the White House Conference. At least I remember it coming up there.

I feel that the underlying idea was mistaken. All the people wanted to do was to have a more advance notice of who the companies are that were bidding so that, as a result, they could then prepare for best and final offer strategies and, more importantly, if they felt it was a challenge to the small business status, they would not have to wait for the 5 day thing after award. So, they said that if the bids are in, we would like to be able to get a list of bidders.

Now, that is a much more reasonable request, and simple for a contracting officer to comply with, if, in fact, he would, since the list is clear and the list is there.

So I think the intent was simply that once the bids went in, especially in negotiated contracts and things of that nature, where there is a considerable time between the time the bids go in and the evaluation goes on, and so forth, the companies would have plenty of time to ask the contracting officer to get a short list of who went in, who were the bidders, and then, if they were going to protest, they could prepare in other than a panic kind of fashion.

I think that was the intent of the whole thing, that the access of the list would be before award, not before solicitation, which I think has happened.

With regard to S. 1559, we agree on the change in fair proportion from the SIC to the Federal Procurement Data System as an interim measure. But, frankly, I am not very familiar, and I don't think most companies are very familiar with the FPDS, and if it is adequate, for example, why don't we use it for procurements and size standards, if it is such an adequate system?

If it is inadequate, we need to evolve a meaningful system for procurement, as I have mentioned.

The switch to fair and reasonable price we feel is fine for the reasons that were stated before.

With respect to the small purchase reserve, we supported the idea of a small purchase reserve exclusion at the $25,000 threshold.

I should explain that the reason we do that is because our understanding—and I have heard over the years back and forth—our feeling in the small business community was that the under $25,000, or previously $10,000, threshold was a small business preserve, and, therefore, as was mentioned earlier by the gentleman from DOE, it would be more or less that you go to small business unless there is some overriding why not.

In fact, we have always been kind of disappointed that something like only 50 percent of those procurements go to small business, even despite that intent.

So we would say, you know, more or less leave the small purchase reserve alone. I do agree that it should be changed to $25,000 to stay consistent; but, in fact, that the goaling and so forth should use the procurements above that.

There are other reasons, too, and I think the administrative complaints of the agencies would be true. There are truly millions and millions of actions there.

We agree with the interim move in S. 1559 to relax the 50 percent rule. We recommend further study to insure the mechanism is adequate to prevent fronting.

We especially recommend the adoption of the applicability of this 50 percent rule change. We especially recommend the adoption of that part of S. 1559 because we have a peculiar thing. My understanding, again, in talking to and getting a reading from the House Armed Services Committee, that particular part of the law says that the 50 percent rule applies to contracts signed after October 1, 1987.

Now, if that is the case, it is something I think probably of an oversight nature, you know, an inadvertent mistake. Normally you would say for solicitations starting after October 1 or some other date in 1987.

The problem here is that there are many contracts that are going to be signed after October 1, which have the solicitations but which have been on the street for months. Proposals in most cases are in. The evaluations are underway. What will happen is after October 1, when they move toward an award and a signing of the contract, anyone who is a loser could protest legitimately that procurement, if the 50 percent, or the subcontractor limitation clause was not in the RFP and was not considered during the evaluation of the contract.

I think that that is a very hard problem facing us here and could cause even more chaos in the procurement system later this year.

We agree with the repeal of the list of candidate bidders provision, although we feel that you could change the wording to "bidders" rather than just "candidates for bids" and meet the small business requirement.

We agree that changes in section 15 should be accompanied by conforming amendments to section 8(a), and we feel the October 1 effective date is important, especially in the subcontractor limitations wording exchange.

We are currently involved in a contract with a naval agency where it is a Small Business Set-Aside Program, and the size standard being used, because it was the only one available, was $13.5 million a year for the last 3 years.

This is a job that ranges across many disciplines and involves sales of $15 million a year for at least 3 years. It may go a little bit more than that.

The RFP came out with the subcontractor limitations clause in it because I had gone down and had talked to the CO at the base and made him aware of it. Their contracting people had not been aware of it earlier this year. Of course, the regulations had not been written.

The upshot of the thing was that it came out, proposals were about to be submitted in mid-August, the senior contracting person came up to Washington to get briefed on the new regulations, and she mistakenly took that the subcontractor limitation provisions only applied to the 8(a) contracting. So she ran over and grabbed the phone and called down to the naval agency and said pull the 50 percent provision out of the RFP. They gave everyone a 2 week extension, and now the proposals have all been submitted and this provision is not in the RFP.

We don't know what is going to happen, but I think there are a lot of things that are involved in this procurement relative to size standards, inadequacies of SICs, and the size of contracts versus the 50 percent rule, and the chaotic nature that the contracting officers are in, to be changing things over the phone, and so forth, and now have basically a flawed RFP on the street—this points out the thing we started with.

I apologize that I took a little longer than I had intended and I appreciate your listening to my comments.

[The prepared statement of Mr. Rennie follows:]

Testimony
before the
United States Senate
Committee on Small Business
Subcommittee on Government Contracting and Paperwork Reduction

concerning

Amendments to the Small Business Act
contained in P.L. 99-661 and proposed
in S.1559

by

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Mr. Chairman and Members of the Committee:

I appreciate very much the opportunity to testify here today and would like to commend you for the care and interest the Members of the Committee have shown in addressing the sometimes confusing and, I'm sure, perplexing aspects of procurement reform.

Today I represent National Small Business United (NSBU), a nation-wide, all industry, grassroots small business advocacy group with over 40,000 members, many of whom are directly involved or vitally concerned with the efficiency and effectiveness of the federal procurement system. I am the Chairman of NSBU's government procurement committee. In appearing here today, I am also relying on my almost 30 years of experience in the federal procurement arena, first as a Naval Officer, test pilot and technical program manager in the Navy's RDT&E community and for the last twenty years as President of Pacer Systems, Inc., a company which supplies both professional technical services and hardware to the government, both as a prime and subcontractor. Pacer has grown from one employee to almost 450 employees; the company currently has employees stationed in 15 locations in nine states and the District of Columbia. In addition, I was honored to be selected as the Commissioner of the Federal Procurement Issue Area in the 1986 White House Conference on Small Business, a most valuable addition to my perspective in matters related to todays topic.

I intend to comment on certain specific amendments to the Small Business Act brought about by passage of P.L. 99-661, the FY 87 Department of Defense Authorization Act. In doing so, I will allude to and offer comments/observations concerning the Report prepared by the Small Business Administration (SBA) for the House and Senate Small Business Committees on this same subject. I will also offer comments concerning S.1559, the proposed "Small Business Federal Contracting Restoration Act of 1987", as the committee requested in its letter of invitation to this Hearing.

General Remarks

Before I get to my more specific remarks, Mr. Chairman, I would like to offer some more general observations bearing on the current state of procurement. These opinions have been formed as one operating in the federal procurement arena first-hand, and in participating in numerous procurement-related meetings and debates within the small business sector over the past five years. These comments may, I hope, lend some "texture" to my subsequent remarks and indicate the overall mood I sense in this extremely important part of government operations.

First, I must say that in all my years involved in this industry (on both sides of the "fence") I cannot recall a time when the relationships between the government (especially DOD) and its contractors has been so poor; I cannot recall a time when the morale of Defense suppliers has been lower; and I cannot recall a time when the entire procurement picture has been so confused at the operating level. I cannot help but think that the net result of this situation, if it is allowed to continue, will be a deterioration in the results of government acquisition, ie. the goods and services procurement will more and more often fail to meet requirements and will be of poor quality; and the already alarming shrinkage of the government's industrial base will progress still further.

This situation has developed despite the well-meaning efforts of many people at all levels. But in recent years, the confluence of events and major, long term characteristics of the system has caused what I feel is a possible disaster. Let me give you an idea of some elements of the scene as I see it to indicate the dimensions of my concern:

a. Misunderstanding and Mistrust. There has developed an attitude of hostility and mistrust between those in positions of responsibility in procurement in the government and the industries they deal with. Much of this has arisen because the individuals on both sides simply don't understand and respect the needs, constraints and perspectives of their counterparts; but in the past four or five years these feelings have been exacerbated by numerous public pronouncements which have laid all problems of procurement at the feet of industry...rather than rightfully pointing out a more balanced assessment of blame. This "contractor bashing" is convenient for public officials, but it is bitterly resented by industry which must deal with the public, the press and financial community while fearing to point out that many problems have nothing to do with industry per se but the system itself. DCAA which used to be looked upon as a constructive, helpful agency, is now considered hostile and not to be trusted.

The attitudes engendered remind me of the past U.S. conflicts between labor and management...thought to be constructive but now discredited as unenlightened and largely counterproductive.

I cannot, in a few words convey adequately to you how disturbing this has been to the system.

b. Basic Procurement Flaw. I feel the single most important basic problem in procurement is the "disconnect" that has occurred between the needs of those with program responsibilities in the government and the entire process of the movement of contracting paperwork. If a program manager has to achieve goals or milestones according to a calendar, how can he/she do this in an orderly way, compliant with Congressional and agency directives, when it takes a minimum of eight months to run a competition? The answer is: he/she can't. As a result, these conscientious people do what you or I would probably do...they find a way to do it legally, to meet their responsibilities.

This "disconnect" gives rise to many, many "symptoms" such as: fewer meaningful competitions; larger, multi-year procurements; and increased use of Basic Ordering Agreement (BOA) and Indefinite Quantity Contracts (IQC). Needless to say, most of these trends favor larger contractors and those already in the system.

These "symptoms" are picked up by observers of the scene and attempts are made to solve the problems arising from them...leading to a "patching of the balloon" approach to reform, but no fundamental change to the basic problem.

Lately, this has been worsened because the contracting branches have become preeminent in many agencies in the zeal to comply with the Competition in Contracting Act's exhortation toward maximum competition and the resulting emphasis at the operating level to mindless low bid awards. Now, the people with technical responsibilities have the procurements taken out of their hands and we have the contracting people in charge. Let me tell you that when the contracting people in my company take over, the Company is doomed! I feel the same about the government agencies.

C. Failure to Address Elemental Questions. Despite sincere efforts of many people over the past ten years, small businesses still find many de facto barriers to entry into the procurement system. Why? Why are the jargon, paperwork and contracting procedures still as complicated as ever (except SBIR)?

Why is it that agencies' requirements are not known (or easily found out) before they show up in the Commerce Business Daily?

Why is it that we are still fooling around with the SIC Code system for use in procurement when the codes are set up for the purposes of economists and are clearly inadequate for our purposes?

Why is it that after all these years P.L.95-507 has had little effect in the real world? Could it be that we need to structure a system based on real, meaningful incentives rather than the "velvet hammer" approach?

Why is it that government specifications and standards and data packages are so often unavailable in a timely fashion?

The point is that a lot of people spend a lot of time and earnest effort trying to "fix" surface problems when what is needed is a much more sweeping, elementary approach to devising a new or alternative system.

d. Outside-the-Beltway Magnifier. Finally, I'd like to mention something of which I constantly have to remind people here in Washington...the huge magnifier effect that occurs between the statement of policies, procedures or regulations here in Washington and what actually happens in the hinterlands at the operating level. If a public official here just hints at something...a possible change in emphasis on source selection criteria for example...people all over the Country go to general quarters! If the Secretary of the Navy, for example, is seen on the six o'clock news

> espousing a "new get-tough policy" on this or that, many personnel overreact, causing unnecessary distress in the field. The natural tendency of people in a bureaucracy is to be on the "conservative" side of policies so that they will not be vulnerable to criticism...being "out of step".
>
> In the past three or four years, with the large number of laws and regulations concerning procurement enacted or promulgated, this effect has been even more noticeable. So, it is most important that higher level officials be responsible in public statements and provide guidance quickly to field activities when real changes are agreed upon. A "hot line", of sorts, would be helpful so that concerned contracting officers, for example, could get a quick, authoritative answer to questions or "rumors".

Well, let me now address specific aspects of the P.L. 99-661 amendments to the Small Business Act.

"Fair Market Price"

My sense of this is that the conclusion expressed by SBA in its report that "references to fair market price should be construed as synonymous with reasonable price...and that current standards are adequate to govern both 8(a) and set-aside awards", is correct.

I have read comments that drew the distinction between the terms "fair market costs" (statute) and "fair market price", (regulation), supposing the difference was fee. If that is the case, then a clarification is needed. I took those terms somewhat differently and supposed that the regulation drafters were using the terms interchangeably, ie. the "price" offered by the seller becomes a "cost" to the buyer, but the amount would be the same.

The ability of a contracting officer to determine a "fair market price" will vary greatly depending on how well the product or service to be delivered can be defined. If an item is described in detail, a reasonable price range should be easier to determine by reviewing recent contractual history and/or submitted bids. However, if the delivery is less defined at the outset, quality, innovation and other such factors become more important. In these latter procurements, price should become less heavily weighted anyway; and therefore differences in price should be less important to the award.

The language in CICA emphasizing the lowest possible cost has been the cause of great problems in R&D, Professional and technical services and other procurements where quality is (or should be) much more important. It is encouraging that some efforts are underway to provide for greater emphasis on quality in these competitions.

"50% Rule"

I strongly feel that this Rule is flawed; and I agree with the conclusions of the COC Specialists survey reported in the SBA Report, ie. that the Rule will result in a decrease in small business contracting. I feel this because the requirement for the prime to do 50% of the work will result in a number of decisions by contracting officers that certain, larger contracts should not be set-aside because small firms would not be able to handle 50% of the work.

This conclusion is reinforced because upon investigation I have determined that on IQC-delivery order and other such contracts, each task is considered a "separate contract" of sorts, and thus the prime contractor would have to perform 50% of each task. Clearly, this puts even greater burdens on the prime, further complicates administration and runs counter to the whole idea of teaming by companies with complementary capabilities. It is interesting to note, for example, that a small firm could compete in an open competition (ie. non-set aside) and not have to comply with this rule, thereby giving it considerably more flexibility (and credibility) than if it were bidding a set-aside.

Although I certainly agree with the goal of eliminating "front" companies, the 50% rule just causes too many problems. As a result, I feel the Rule should be repealed or otherwise put on hold until a better solution can be formulated. Several alternatives I could suggest for evaluation are:

a. Reduce the prime's role to the 25% range;

b. Allow the 50% (minimum) to be accomplished by certifiably small, unaffiliated companies, including the prime;

c. Reduce the size of contracts to which the Rule applies to a maximum of $2 million per year ($8 million total)

All of these have drawbacks and may be inappropriate, depending on the size standards applicable to the contract.

With regard to size standards, I feel this Rule, if left in force, should cause a reevaluation of appropriate standards, probably resulting in an increase in many categories.

(Parenthetically, with regard to the SBA Report, I felt that this section and others were much too dependent on data gathered from the A&E and construction segments of the small business community. As we have seen in many other issues, these two segments exhibit quite different characteristics and attitudes from small business in general. Therefore, one can be misled by reliance on conclusions reached by examining these groups.)

I do agree that monitoring contract value rather than costs would simplify accounting and monitoring.

Goaling

Absent any better approach (and, as I have indicated, I feel there are better approaches based on incentives), I feel setting goals is helpful to small business in that at least it keeps the idea of increased participation by small and minority businesses in front of public officials.

However, it is most important that goals be reasonable and achievable; else they will cause resentment and largely be ignored.

I am of the opinion that the goals set for small disadvantaged businesses (SDB) of 5% of virtually all of DOD contracting for FY 87, 88 and 89 were excessive and not workable. This has been recognized recently by the DOD itself, as an interim rule was published providing a new SDB set-aside which would pre-empt other small business set asides. The difficulty was that DOD realized it could not meet these goals (which were accompanied by significant penalties for failure to achieve them) within its current contracting rules and procedures. While part of this is due to flaws in the procedures, it is also true that these goals represent a dramatic increase in funds to be channeled to this group of companies (on the order of $8 billion annually), far in excess of amounts absorbed previously by this same group. So the interim rule attempts to establish a mechanism to "move money".

The establishment of the SDB set aside is a very negative development, in my view. First, it adds even more complication to the contracting officer's job; it is almost certain to result in abuse because it is intended to force funds to an industrial sector not likely to be able to absorb it legitimately, involves self-certification and involves access to data which is difficult to obtain and monitor in privately-owned firms; and is certain to cause a serious rift within the total small business communities, once companies around the Country hear about it...and most of them haven't yet.

Further, I must say that this type of program causes us who often testify on procurement matters to struggle to draw differences between small business programs. Those who wish to, group all small business programs together, branding all with the label of "anti-competitive" or "abusive". We don't need that complication.

Finally, I strongly object to the notion that the Interim Rule should be put into effect prior to review under the Regulatory Flexibility Act. Even the originators of the Rule surmise that there will be adverse impact on the small business community. This is the very essence of Reg-Flex! To implement the Rule under these circumstances is unconscionable. If another rule is anticipated that is also likely to require a small business impact study, then the first Rule should be held in abeyance until the second Rule is published; and they can be analyzed together.

With regard to goaling vis a' vis small purchase thresholds, I feel a $25,000 threshold should be used to be consistent with the recently revised small purchase definition. In other words, I feel that small purchases (ie. under $25,000) should be outside the goaling levels stipulated.

"Fair Proportion by SIC"

The idea for setting set-aside proportions across all industry segments emerged from the White House Conference in 1986. The thrust of the recommendation arose because certain agencies tended to put all (or a large proportion) of their set-aside procurements in one or two areas; in this way they met small business requirements technically, but had numerous areas of procurement "roped off" from small business. In some circles this practice was informally referred to as "corralling". So the idea was to force agencies to spread small business participation across all procurement areas.

In the process of forming legislation, the term "across all industry segments" was changed to mean across all SIC code areas. Of course, in attempting to implement this, agencies immediately ran into trouble because there are so many SIC codes; and contracts are recorded under the FPDC coding system (not SIC's). Also, not said is that the SIC Code system inadequacies prevent meaningful compliance. By the way, I feel the SBA Report fell into the same trap as many others, ie. making inferences from SICrelated data. For example on page 40, it concludes that "government procurement dollars are highly concentrated in a small number of industries". I submit that the problem is that the system is so inadequate that such conclusions are suspect and not meaningful in operational terms.

Another look at this idea needs to be done so that a meaningful breakout of procurements, especially with applicability to small business, could be formulated. Then a reasonable monitor could be developed with practical goals (not necessarily the same) for each sector.

SIC Basis for Size Standards

Needless to say, I feel that codification of this is not wise; so I agree with SBA Report's conclusion in this regard. Again, I feel another system is desperately needed upon which meaningful size standards could be based.

Listing of Set-Aside Bid Candidates

I feel this resulted from a misunderstanding of a White House Conference recommendation. The idea was to have a list of bidders available before award so that a bidder could find out who the competition was. This would allow the bidders to prepare strategies for Best and Final Offers, post-award challenges, etc. Somehow, this was interpreted to mean that the contracting officer was to get a list together even before announcement.

In the idea from the small business community, a company could inquire after proposals were submitted but before award. Of course, at this stage the contracting officer would have the list of companies which had bid; and no additional work would be required.

I agree with the SBA Report's conclusion on the impact of this requirement on contracting officers with the requirement (as it is stated in the statute). But because I feel this was a misunderstanding anyway, if the requirement is changed, I think contracting officers would have no problem with it.

Comments on S.1559

Mr. Chairman, as you could infer from my previous comments, I feel that the amendments to the Act brought about by the provisions of P.L. 99-661 have caused numerous problems. So, I commend you for taking steps to remedy these shortcomings (or, at least, some of them) in S.1559.

a. Fair Proportion of Total Federal Contracting. As I have stated, I feel that basing the proportionality on the SIC Code system is impossible at this stage and exceeds the thrust of the original idea. On the other hand, I feel the notion of spreading procurements is a good one. Therefore, I agree with this provision in

S.1559 to remedy the ongoing compliance problem. However, I do not know whether the use of the FPDS categories as a basis will adequately meet the original idea, as like most contractors, I am very unfamiliar with that system.

The switch to "fair and reasonable price" is acceptable to me for the reasons previously stated in my statement and concluded by SBA.

b. Small Purchase Reserve Exclusion. I agree with this amendment.

c. Subcontracting Limitations. since I have indicated that the 50% Rule is flawed, I agree with the change proposed to Section 15(o)(1) which would, in effect, relieve the strict requirements of the Rule as currently stated.

It may be that this wording (ie. S.1559) would be adequate for the future. But I would recommend that the Committee seek other possible ways to ensure that the basic focus of the Rule (ie. elimination of "fronting") is upheld and subject to oversight for compliance. If no suitable method can be found, this wording can serve to provide guidance and convey the intent of Congress.

I do not understand the intent of the proposed change to Section 15(o)(2). It seems to me that if the change to 15(o)(1) is enacted, there is no need for subparagraph (2) at all.

I also do not understand why "general and specialty construction" should be singled out for special treatment under these provisions, especially if the change to 15(o)(1) is enacted. Therefore, I would tend to eliminate paragraph (3) altogether.

I strongly endorse the change contained in S.1559 Section 4(b). I believe it was an inadvertent oversight that the drafters of P.L. 99-661 included wording which made the subcontractor limitations requirement effective for contracts signed after October 1, 1987. The provisions of P.L. 99-661, translated into amendments to the Small business Act have only recently emerged in the Regulations. (Actually, I do not know if regulations have been promulgated yet.) In any case, most solicitations for contracts to be signed after October 1 have already been released. Indeed, in most cases I would suspect that the proposals have already been submitted. As a result, I can envision numerous contractual actions which will be non-compliant with this provision, leading to many protests and cancellation of procurement actions if the current wording is allowed to stand. So, a change to solicitations issued after October 1, 1987 is a logical and urgently needed change.

d. Repealer. I agree that this provision should be repealed, as my view is that it was drafted mistakenly on the basis of a misperception of the desires of the small business community.

If an amendment could be generated which would direct contracting officers to make available the list of those companies which have submitted proposals/bids/quotations on a given procurement, I feel the needs of the small business community would be met.

e. Conforming Amendments. It is consistent to amend Section 8(a) in the same manner as Section 15, as they were similarly changed by P.L. 99-661. My previous comments in subparagraph (a) above would apply here.

f. Effective Date. Even though I know the time is short, I feel it is imperative that the provisions proposed in S.1559 be adopted immediately, ie. by October 1, 1987. If this is not done, I feel that an already confused system could become chaotic, especially with regard to the subcontractor limitations Rule implementation.

I disagree with sentiments I have heard that the P.L. 99-661 amendments should be let stand for a year, to see what happens. We can surmise pretty well what will happen; and it will be detrimental to small business and the system as a whole.

Thank you, again, Mr. Chairman. I hope my comments on behalf of NSBU are helpful, as they are offered in a constructive manner. Our Association and I are most anxious to continue to work with you in improving the effectiveness of the procurement system and in increasing participation in that system by all segments of the small business community.

I'd be happy to try to answer any questions you or Members of the Committee may have.

Senator DIXON. I thank you very much.

I thank you, Ms. Williams, and you, Mr. Rennie. We very much appreciate your time.

Ms. WILLIAMS. Thank you.

Mr. RENNIE. Thank you, Mr. Chairman.

Senator DIXON. Next we have Mr. Arthur A. DeFraites, chairman, Committee on the Federal Procurement of Architectural/Engineering Services; and Sharon Fischer, president of Priceless Industries of Baltimore, representing the American Subcontractors Association. This is Panel III.

Mr. DeFraites, you are listed first on our agenda. If Ms. Fischer has no objection, perhaps you would proceed.

Ms. FISCHER. That is fine.

STATEMENT OF ARTHUR A. DeFRAITES, JR., CHAIRMAN, COMMITTEE ON THE FEDERAL PROCUREMENT OF ARCHITECTURAL/ENGINEERING SERVICES, WASHINGTON, DC

Mr. DEFRAITES. Thank you very much.

Mr. Chairman, my name is Arthur DeFraites, Jr. I am a consulting engineer and professional land surveyor from Houma, La. I am currently serving as the chairman of COFPAES, the Committee on Federal Procurement of Architectural/Engineering Services.

COFPAES represents major architectural, engineering, and surveying—A/E—professional societies.

The purpose of our committee is to promote sound Federal procurement practices for A/E services.

The A/E professions have encountered some problems in the procurement area, particularly in the designation of size standards, whereby the overwhelming majority of A/E firms are classified as small business and in the application of the so-called Rule of Two.

I think we need to set out a definition to begin with.

The A/E services that my group and society are interested in are those A/E services that relate primarily to real property, rather than to personal property, such as the design of weapons, military equipment, military engineering, and naval architecture.

We see a definite distinction between those two.

SBA seems to group these all together into one group and classification.

The second concern that I think needs to be defined is what your objective is. Is the objective to award contracts to small businesses at a reasonable level or to award them through set-asides?

We have a vast difference between awards through set-asides and awards overall in our industry.

On the size standard issue, it is important to observe that the architectural, engineering, and surveying professions have been struggling with SBA for years to promulgate size standards that are reflective of competitive conditions within the design profession.

SBA's 1986 action to lower the A/E size standard from $7.5 million a year for engineering and $3.5 million a year for architecture, to a combined A/E standard of $2.5 million average annual income was a step in the right direction.

However, even under this greatly reduced size standard, 97 percent of America's practicing architects, 95 percent of engineers, and 99 percent of surveyors are considered small business.

Thus, the size standard definition is not very helpful in assisting truly small and minority A/E firms in obtaining a fair share of Government business.

I would like to comment on the averaging of this income.

At the present time, the income is determined over the average of the last 3 years' income of these firms. In America, we greatly like the idea of growth.

What the averaging process does in a growth industry is to allow a firm that becomes big to be considered small for a longer period of time. In south Louisiana, we happen to be in a depressed area right now, and we are declining. In a declining situation, when you most need the help of Government assistance to keep your business going in architecture and engineering, the averaging process precludes a small firm from competing. As you pass from a large-firm status to a small-size status, the averaging process keeps you out for 2 additional years before you can probably compete again.

So, averaging is a problem to us.

A basic purpose of the Small Business Act is to provide opportunity for market entry for small firms. Because practically all A/E firms are still defined as small business, the smaller firms are in direct competition with larger firms. Thus, in the A/E procurement field, there really is no preference opportunity for small A/E firms because virtually all firms are defined as small.

This adverse situation for the truly small A/E firms is further compounded by the Rule of Two.

While the Rule of Two may be appropriate for many industry groups, its application to A/E professionals has caused hardship, particularly in the small firms.

Senator DIXON. Can I interrupt at that point?

Mr. DEFRAITES. Yes.

Senator DIXON. How does the Rule of Two apply for a professional service? I don't know that I am clear on that.

You don't take a competitive bid, really, on a professional service, do you?

Mr. DEFRAITES. No.

The problem is in the set-aside activity.

What is happening is that for practically every job there is always at least two architectural or two engineering firms that can compete. So, when this rule is applied to an A/E procurement process, we end up with practically everything being set aside.

So, if you take the Corps of Engineers, and so forth, and go right on down the line, when the Rule of Two is applied to an A/E procurement process, practically everything is set aside. That is the problem.

Senator DIXON. I see. Thank you, and pardon me for interrupting.

Mr. DEFRAITES. Certainly.

Last year, Congress enacted a provision that would change existing law which permits a virtual total set-aside of all contracts in a particular industry category to a process whereby every industry category would be entitled to receive a fair share of Federal contracts.

Congress also directed a review of size standards applicable to architectural, engineering, surveying and mapping services.

The SBA was directed to reduce the size standards for the A/E professions if over the past 3 years more than 30 percent of the dollar amount of Federal A/E contracts awarded were awarded to small business A/Es. We favored this review and welcomed the congressional attention that was and is being devoted toward small business issues.

We participated in the SBA analysis and size standard review that was called for under section 921. But we were profoundly disappointed by SBA's two volume report that was submitted to you on July 14. The SBA report omits reference to vital A/E contracting data.

Furthermore, conclusions drawn from the data that were presented are illogical and not helpful to small business A/Es interested in acquiring Federal work.

We called SBA's attention to the fact that Congress requires the Department of Defense, the agency responsible for over 70 percent of the Federal A/E contracts awarded each year, to seek open competition for all A/E contracts over $85,000. Contracts below that amount are reserved exclusively for small business A/Es.

We provided to SBA data from DOD covering the fiscal years 1984 through 1986, which showed that small business A/E firms received 80 percent of the contract actions and 62 percent of the dollar amounts.

We observed that while A/E small business set-asides decreased under the DOD $85,000—in other words, the actual amounts awarded under the set-asides decreased—the number and the value of contracts awarded to small business A/E firms under open competition remained consistent, and were a "fair proportion" of the amount of the total awards made.

In other words, small business A/Es received the lion's share of Department of Defense awards under the open competition programs having the $85,000 ceiling.

Regrettably, SBA ignored this data, which represents the bulk of the total governmentwide A/E contract award and failed to make mention of it in its report to Congress.

SBA concluded that the A/E size standards need no adjustment since less than 30 percent of the A/E contracts are set-asides. This goes back to how you make the award. Do you make it through fair and open competition, or do you make it solely through the set-aside concept?

We submit that SBA has completely missed the point of the section 921 study and directives to adjust the size standard so that approximately 30 percent of the value of contracts are awarded to small business A/Es.

We acknowledge and applaud the reduction SBA has reported for surveying—from $2.5 million to $250,000. Quite honestly, we don't really see a big difference between engineering, architecture, and surveying. We are all a very closely related group. But they have chosen to take surveying out and lower that particular one.

We question why SBA was so inconsistent in separating surveying, but not architecture and engineering, as each now has its own SIC. Nor do we understand why all three disciplines were not considered in total, as they were under the SIC system in effect on the date of the enactment of section 921.

As we noted earlier, set-aside programs are beneficial to small firms, but not when virtually all firms are defined as small business.

Because SBA is unwilling to adjust the A/E size standards to a more realistic level—for example, so that 30 percent of Federal A/E contract dollars are earmarked for firms considered as small business, as called for by section 921—we suggest that this Committee consider other ways of assuring that a fair portion of Government contracts are awarded to small business.

One approach would be to expand the $85,000 threshold program governmentwide—in other words, both Department of Defense and civilian.

Another would be to have a 2 year moratorium on A/E set-asides for civilian agencies.

We believe either approach would demonstrate that under the present SBA size standards, small business A/Es would receive over 60 percent of the Federal contract dollars and action.

If the Set-Aside Program is to continue to apply to A/E contracts, the A/E size standard must be adjusted to a more realistic level and the Rule of Two must be eliminated.

At the present time, we still have S. 1559 under review, we are concerned with the provision that goes back to keeping the awards total.

Senator **DIXON**. May I interrupt you there, Mr. DeFraites.

I don't like to talk to my staff while you are testifying, but I am trying to get a better understanding of this. I hope you understand that I am not an expert in this field.

Now, on the professional bids, you don't compete like two people bidding to get a job, right?

Under the Brooks amendment, as I understand it, there is a negotiated process by which you make a determination about qualifications and other things and achieve a fair and reasonable price.

I am over-simplifying, but is that essentially right? Are you saying that doing it by that process, without set-asides, you still say that 60 percent of the business out there goes to small businesses?

Mr. **DEFRAITES**. That is correct. That is based upon the actual statistics furnished us by the Department of Defense after 3 years of using the $85,000 level.

It is true that the small business set-aside awards declined to the 8 percent that SBA mentioned; but the total contracting amount and the number of awards was in excess of 80 percent, and the dollar amount was in excess of 60 percent.

So we feel that the Brooks bill procurement procedure will work fine in matching up the size of the firm with the size of the job.

Senator **DIXON**. Of course, we are not trying to change anything about that?

Mr. **DEFRAITES**. No, sir. We do not propose to do that.

We don't really necessarily feel that a Set-Aside Program for architecture, engineering, and surveying service is needed at all.

We really feel that we can get, and your statistics will prove to you as the program continues along, that without the Set-Aside Program, small business will get a lion's share or better than half the jobs anyway.

Senator DIXON. I hear what you are saying.

Mr. DEFRAITES. That is the distinction that we are trying to make, sir.

Senator DIXON. You are simply saying that in your profession, without set-asides, you are still getting 60 percent of the business at the small business level.

Mr. DEFRAITES. Yes, sir.

Senator DIXON. OK. Thank you.

Mr. DEFRAITES. My last comments addresses S. 1559.

We understand the problem with the SICs. In fact, under the SIC system, the architects and engineers apparently are still grouped with naval architects, weapons architects, and all this other kind of stuff, which we really don't feel that any of our group falls in the same category with.

So that may not be the right answer.

But going back to a total grouping in the construction industry, for example, that has not served us well at all, because we have found from past experience that the Corps of Engineers, the VA, and other people achieve their set-aside standards by taking the A/E services and setting those aside, so that contractor and other activity does not have to be set aside. We end up between the Rule of Two, between the total contracting situation, with practically all architectural and engineering services being set-asides.

Senator DIXON. Ms. Fischer, please know that I will get to you in a moment.

In other words, what you are saying is that when you talk about the totality, you believe you are a "picked-on" classification.

Mr. DEFRAITES. Yes, sir. We are.

Senator DIXON. I see some nods out there in the audience on that one. [Laughter.]

OK. I understand. Thank you.

[The prepared statement of Mr. DeFraites follows:]

COFPAES
COMMITTEE ON
FEDERAL PROCUREMENT OF
ARCHITECTURAL/ENGINEERING
SERVICES

American Congress on Surveying & Mapping
American Consulting Engineers Council
American Institute of Architects
American Society of Civil Engineers
ARTBA Planning & Design Division
National Society of Professional Engineers

STATEMENT

By

COMMITTEE ON FEDERAL PROCUREMENT
OF ARCHITECTURAL/ENGINEERING SERVICES

To

SENATE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON GOVERNMENT CONTRACTING
AND PAPERWORK REDUCTION

Concerning

SMALL BUSINESS PROCUREMENT ISSUES AFFECTING
THE ARCHITECTURAL, ENGINEERING AND SURVEYING PROFESSIONS

September 21, 1987

Mr. Chairman, my name is Arthur A. DeFraites, Jr. I am a consulting engineer and professional surveyor from Houma, Louisiana and Chairman of the Committee on Federal Procurement of Architectural/Engineering Services (COFPAES). COFPAES represents the following major architectural, engineering and surveying (A/E) professional societies:

American Congress on Surveying and Mapping
American Consulting Engineers Council
American Institute of Architects
American Society of Civil Engineers
ARTBA Planning and Design Division
National Society of Professional Engineers

The vast majority of America's practicing architects, engineers and surveyors belong to these societies. The purpose of our Committee is to promote sound Federal procurement practices for A/E services. As you may know, the Federal government is a major client of the A/E professions. We appreciate this opportunity to present our views on small business procurement issues of concern to the design professions.

When the Federal government requires A/E services it utilizes a procedure whereby: the opportunity is publicly announced so that all firms have an opportunity to compete;

interested firms submit their qualifications to the agency; thereafter, the most qualified firm is selected subject to the negotiation of a fee that is fair and reasonable to the government. This process is embodied in the so-called Brooks Act, P.L. 92-582, enacted in October 1972. The law has worked well and is supported by the A/E professions and the Federal construction agencies. Indeed, Congress underscored the viability of the Brooks procedure by recognizing the process as fully competitive within the parameters of the recently enacted Competition in Contracting Act (P.L. 98-369).

The A/E professions have encountered some problems in the procurement area, particularly in the designation of size standards whereby the overwhelming majority of A/E firms are classified as small business and in the application of the so-called "Rule of Two."

On the size standard issue, it is important to observe that the architectural, engineering and surveying professions have been struggling with SBA for years to promulgate size standards that are reflective of competitive conditions within the design professions. SBA's 1986 action to lower the A/E size standard from $7.5 million and $3.5 million to a combined A/E standard of $2.5 million in average annual receipts was a step in the right direction. However, even under this greatly reduced size standard 97% of America's practicing architects, 95% of engineers and 99% of surveyors are considered small business. Thus, the size standard definition is not very helpful in assisting truly small and minority A/E firms in obtaining a fair share of government business.

A basic purpose of the Small Business Act is to provide opportunity for market entry for small firms. Because practically all A/E firms are still defined as small business, the smaller firms are in direct competition with larger firms. Thus, in the A/E procurement field there really is no preference opportunity for the small A/E firm because virtually all firms are defined as "small." This adverse situation for the truly small A/E firm is further compounded by the Rule of Two.

While the Rule of Two may be appropriate for many industry groups its application to the A/E professions has caused hardship, particularly to small A/E firms. Fortunately, Congress with considerable leadership from this Committee has been quite receptive to both the size standard and Rule of Two issues as they impact the A/E professions.

Last year the Congress enacted a provision (Section 921, Title IX of the Defense Acquisition Improvement Act of 1986, P.L. 99-661) that would change existing law, which permits a virtual total set aside of all contracts in a particular industry category, to a process whereby every industry category would be entitled to receive a fair share of Federal contracts. Under this new provision, 30 percent of the value of contracts would be earmarked for small business A/Es. However, all firms - large and small - would be entitled to compete for the remaining 70 percent of Federal A/E contracts. We think this is in the spirit of various laws designed to assist small business.

Congress also directed (through Section 921 cited above) a review of size standards applicable to architectural, engineering, surveying and mapping services. The SBA was directed to reduce the size standard for the A/E professions if over the past three years more than 30 percent of the dollar amount of Federal A/E contract awards were awarded to small business A/Es. We favored this review and welcomed the Congressional attention that was and is being devoted toward small business issues.

We participated in the SBA analysis and size standard review that was called for by Section 921. But we were profoundly disappointed by SBA's two volume report that was submitted to you on July 14. The SBA report omits reference to vital A/E contracting data. Furthermore, conclusions drawn from the data that are presented are illogical and not helpful to small business A/Es interested in Federal work.

We called SBA's attention to the fact that Congress requires the DOD, the agency responsible for over 70% of Federal A/E contract awards each year, to seek open competition for all A/E contracts over $85,000 (see attached letter to SBA). Contracts below that amount are reserved exclusively for small business A/Es. We provided to SBA data from DOD covering FYs 1984-86 which showed that small business A/E firms receive 80% of the contract actions and 62% of the dollars. We observed that while A/E small business set asides decreased under the DOD $85,000 threshold program the number and value of contracts awarded to small business A/E firms under open competition remained fairly constant and were a "fair proportion" by any standard. In other words, small business A/Es received the lion's share of DOD awards under the open competition program having the $85,000 threshold..

Regrettably, SBA ignored this data, which represents the bulk of total government wide A/E contract awards and failed to make any mention of it in its report to Congress. By not explaining to Congress in its two volume report that small business A/E firms receive a very large share of government contracts even though the set-aside level is relatively low the SBA has presented not only an incomplete picture but one from which wrong inferences can be drawn.

SBA concludes that the A/E size standard needs no adjustment since less than 30% of A/E contracts are set aside. We submit that SBA has completely missed the point of the Section 921 study and directives to adjust the size standard so that approximately 30 percent of the value of contracts are awarded to small business A/Es.

We acknowledge, and applaud, the reduction SBA has reported for surveying -- from $2.5 million to $250,000. We question why SBA was so inconsistent in separating surveying, but not architecture and engineering, as each now has its own SIC. Nor do we understand why all three disciplines were not considered in total, as they were under the SIC system in effect on the date of enactment of Section 921. It is also beyond our imagination why SBA completely ignored mapping services in its study when this was specifically mandated in Section 921.

As we noted earlier, set aside programs are beneficial to small firms, but not when virtually all firms are defined as small. The Rule of Two may also be appropriate for some industry groups but it is totally unworkable when the size standard is inappropriate and A/E contracts are earmarked for total set-aside.

It was for these very reasons that Congress directed DOD to reserve all contracts under $85,000 for the exclusive participation of small business A/Es while permitting open competition among all firms, large and small, for contracts over that amount. Because SBA is unwilling to adjust the A/E size standard to a more realistic level, for example, so that 30% of Federal A/E contract dollars are earmarked for firms classified as small business as called for by Section 921 -- we suggest that this Subcommittee consider other ways of assuring that a fair proportion of government contracts are awarded to small business A/E firms. One approach would be to expand the $85,000 threshold program government-wide; another would be to have a 2-year moratorium on A/E set-asides for civilian agencies. We believe either approach would demonstrate that under present SBA size standards small business A/Es would receive over 60% of Federal contract dollars and actions. If the set aside program is to continue to apply to A/E contracts, the A/E size standard must be adjusted to a more realistic level and the Rule of Two eliminated.

In sum, we believe that Congress acted wisely to address long standing problems when it enacted Section 921. The SBA report recognizes that many of the directives established by the section, including determining small business participation on an industry level, are worthwhile objectives that can be achieved.

The Senate should not retreat from the goals of Section 921. The fundamental precepts behind the Small Business Act are furthered by the Section's focus on set aside and size standard issues. While the SBA may not have implemented those goals as well as could be hoped, the goals themselves should not be abandoned. This Committee should and can find ways to build upon the start made when Section 921 was enacted.

Thank you for considering our views.

COFPAES
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April 16, 1987

Ms. Monika Edwards Harrison
Chairman, Size Policy Board
U.S. Small Business Administration
1441 L Street, N. W., Room 600
Washington, D. C. 20416

RE: Small Business Size Standards Applicable to Firms Providing Architectural, Engineering, Surveying And Mapping Services (A/E Services)

Dear Ms. Harrison:

The purpose of this letter is to respond to your request for comments, data and perspectives on SBA's forthcoming review of A/E size standards as required by Public Laws 99-591 and 661. At the outset, we wish to observe that SBA's Federal Register notice of March 17, 1987 is a most constructive effort to establish a dialogue with the industry groups affected by Congress' directive. We look forward to participating in this review and commenting as appropriate.

There are a number of points which we believe SBA should consider as it conducts its review:

(1) A size standard should be set to assure fairness for each industry group within the goals outlined by Congress, not on the basis of what is convenient for an agency to administer. Accordingly, each industry group should be looked at separately and a size standard that makes sense for that group should be established. For A/E services, one size standard applicable to all the design profession disciplines within the A/E category is appropriate, rather than a separate standard for each discipline.

(2) SBA needs to look at several sources of information about the A/E professions including Census data, Federal Procurement Data Center information, Department of Defense statistics and industry records. For your information, we have enclosed recent data published by the DOD

entitled "Architect and Engineering Awards for Construction." What these data show is that under the $85,000 threshold for A/E contracts, mandated by P.L. 98-407, the number of set asides and value of those actions has gone down, but the number of DOD awards to small business A/Es and the value of those awards has remained relatively constant. This demonstrates that small A/E firms are able to compete effectively in the open market.

It may be helpful if SBA were to generate new data on A/E contracting. For example, the Standard Form 254 "Architect-Engineer and Related Services Questionnaire" requires A/Es interested in Federal projects to provide information about gross receipts. Thus, it would be possible for SBA to request agencies to compile information concerning the level of gross receipts of firms that have received contract awards.

We believe it would also be helpful to the SBA if the A/E professions were permitted to comment on whatever data is used to establish the new A/E size standard.

(3) Once a new size standard is established to assure that approximately 30 percent of the value of contracts are awarded to small business A/E concerns, it would be appropriate to include specific provisions allowing interested persons who are adversely affected to petition to be included within the new standard. For example, if a firm's gross annual receipts were on the decline it might be appropriate to consider a procedure whereby that firm's financial position could be sympathetically evaluated.

(4) SBA should consider publishing annual or bi-annual reports (similar to the report DOD provides to Congressional Armed Services Committees) setting forth data on A/E contract awards by all Federal agencies. This would give both the Federal agencies and the professions a useful snap shot on whether the 30 percent goal was being met and in which direction it needed to be adjusted. The process for revising the size standard should not be adversarial as it has in the past. Rather, SBA should revise the standard based upon recent contract data.

* * *

As you carry out the Congressionally mandated review, we would welcome the opportunity to provide additional assistance. Thank you for considering our views.

Sincerely yours,

Arthur A. DeFraites Jr.

Arthur A. DeFraites,Jr.
Chairman

AAD:bc
enclosure

Please reply to: 490 L'Enfant Plaza, S.W.
Suite 3210
Washington, D. C. 20024
(202) 484-6096

ARCHITECT AND ENGINEERING AWARDS FOR CONSTRUCTION 1/
(EXCLUDING NAVAL A&E)
(AMOUNTS IN THOUSANDS)

	TOTAL A & E		LARGE AND SMALL BUSINESS						SET-ASIDES				SMALL DISADVANTAGED							
			LARGE		SMALL		PCT OF SMALL		SET-ASIDES		PCT OF TOTAL		NON-8A		8A		TOTAL SM-DIS		PCT-TOTAL	
	ACTNS	$(000)	ACTNS	$(000)	ACTNS	$(000)	ACTN	AMT	ACTNS	$(000)	ACTN	AMT	ACNS	$(000)	ACNS	$(000)	ACNS	$(000)	ACTN	AMT
ARMY (Excluding Civil Functions)																				
FY 79	1,551	82,133	340	27,577	1,211	54,556	78.1	66.4	42	4,382	2.7	5.3	119	5,649	4	130	123	5,779	7.9	7.0
FY 80	1,275	76,769	284	32,735	991	44,034	77.7	57.4	92	5,016	7.2	6.5	94	3,962	8	209	102	4,171	8.0	5.4
FY 81	1,716	96,517	254	25,630	1,462	70,887	85.2	73.4	663	33,252	38.6	34.5	174	7,162	17	625	191	7,787	11.1	8.1
FY 82	2,216	137,984	230	36,716	1,986	101,268	89.6	73.4	1410	69,872	63.6	50.6	203	8,839	24	474	227	9,313	10.2	6.7
FY 83	1,722	194,451	235	69,832	1,487	124,619	86.4	64.1	1,306	104,753	75.8	53.9	201	14,280	7	1,800	208	16,080	12.1	8.3
FY 84	2,123	205,200	303	58,886	1,820	146,314	85.7	71.3	1,392	106,977	65.6	52.1	228	16,076	11	908	239	16,984	11.3	8.3
FY 85	2,275	243,257	468	100,796	1,807	142,461	79.4	58.5	587	41,138	25.8	16.9	213	16,515	8	464	221	16,979	9.7	7.0
FY 86	1,594	157,578	420	71,070	1,174	86,508	73.6	54.8	180	12,932	11.3	8.2	83	5,493	4	167	87	5,660	5.4	3.6
CIVIL FUNCTIONS																				
FY 79	476	47,072	108	29,833	368	17,239	77.3	36.6	7	592	1.5	1.3	25	1,036	-	-	25	1,036	5.3	2.2
FY 80	383	23,260	98	9,671	285	13,589	74.4	58.4	16	1,312	4.2	5.6	32	1,060	4	600	36	1,660	9.4	7.1
FY 81	488	26,982	114	12,106	374	14,876	76.6	55.1	79	3,266	16.2	12.1	38	1,002	7	252	45	1,254	9.2	4.6
FY 82	319	15,295	99	7,348	220	7,947	69.0	52.0	109	3,564	34.2	23.3	47	1,088	-	-	47	1,088	14.7	7.1
FY 83	141	12,675	29	3,725	112	8,950	79.4	70.6	83	5,824	58.9	45.9	15	662	7	309	22	971	15.6	7.7
FY 84	154	10,022	18	1,314	136	8,708	88.3	86.9	117	6,888	76.0	68.7	10	444	4	600	14	1,044	9.1	10.4
FY 85	183	14,789	25	4,477	158	10,312	86.3	69.7	97	6,673	53.0	45.1	6	280	1	100	7	380	3.8	2.6
FY 86	137	14,202	22	5,456	115	8,746	83.9	61.5	71	5,118	51.8	36.0	6	501	-	-	6	501	4.4	3.5
NAVY																				
FY 79	1,248	61,736	107	7,665	1,141	54,071	91.4	87.6	125	5,258	10.0	8.5	73	2,529	-	-	73	2,529	5.8	4.1
FY 80	1,342	80,123	95	8,563	1,247	71,560	92.9	89.3	575	31,921	42.8	39.8	140	6,420	2	849	142	7,269	10.6	9.1
FY 81	1,664	99,249	143	17,497	1,521	81,752	91.4	82.4	1,229	67,055	73.9	67.6	188	8,720	2	105	190	8,825	11.4	8.9
FY 82	2,234	139,772	148	25,811	2,086	113,961	93.4	81.5	1,903	95,091	85.2	68.0	282	12,051	-	-	282	12,051	12.6	8.6
FY 83	1,884	206,834	241	64,733	1,643	142,101	87.2	68.7	1,472	122,402	78.1	59.2	225	16,446	3	189	228	16,635	12.1	8.0
FY 84	1,816	179,142	203	44,676	1,613	134,466	88.8	75.1	1,242	99,015	68.4	55.3	214	16,716	1	160	215	16,876	11.8	9.4
FY 85	1,994	168,360	306	36,509	1,688	131,851	84.6	78.3	740	51,529	37.1	30.6	297	19,808	2	265	299	20,073	15.0	11.9
FY 86	1,931	184,016	368	49,954	1,563	134,062	80.9	72.8	424	28,169	22.0	15.3	243	19,909	3	113	246	20,022	12.7	10.9
AIR FORCE																				
FY 79	130	9,725	19	3,098	111	6,627	85.4	68.1	31	1,634	23.8	16.8	6	136	1	12	7	148	5.4	1.5
FY 80	148	14,052	13	5,639	135	8,413	91.2	59.9	46	2,166	31.1	15.4	16	915	4	266	20	1,181	13.5	8.4
FY 81	222	11,557	22	2,305	200	9,252	90.1	80.1	158	6,464	71.2	55.9	29	1,309	2	43	31	1,352	14.0	11.7
FY 82	519	19,950	24	1,855	495	18,095	95.4	90.7	380	13,597	73.2	68.2	77	3,057	10	215	87	3,272	16.8	16.4
FY 83	247	17,513	13	1,529	234	15,984	94.7	91.3	189	12,770	76.5	72.9	36	2,328	4	265	40	2,593	16.2	14.8
FY 84	234	18,783	18	2,033	216	16,750	92.3	89.2	148	10,757	63.2	57.3	37	2,366	-	-	37	2,366	15.8	12.6
FY 85	358	30,126	78	10,440	280	19,686	78.2	65.3	75	4,032	20.9	13.4	54	4,288	1	48	55	4,336	16.4	14.4
FY 86	379	28,447	81	9,777	298	18,670	78.6	65.6	50	3,089	15.3	10.8	40	2,603	3	243	43	2,646	11.3	9.3
DLA																				
FY 79	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 80	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 81	1	13	-	-	1	13	100.0	100.0	1	13	100.0	100.0	-	-	-	-	-	-	-	-
FY 82	11	184	-	-	11	184	100.0	100.0	10	167	90.9	90.8	-	-	-	-	-	-	-	-
FY 83	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 84	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
FY 85	1	28	-	-	1	28	100.0	100.0	-	-	-	-	-	-	-	-	-	-	-	-
FY 86	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

ARCHITECT AND ENGINEERING AWARDS FOR CONSTRUCTION 1/
(EXCLUDING NAVAL A&E)
(AMOUNTS IN THOUSANDS)

	TOTAL A & E		LARGE AND SMALL BUSINESS						SET-ASIDES				SMALL DISADVANTAGED							
			LARGE		SMALL		PCT OF SMALL		SET-ASIDES		PCT OF TOTAL		NON-8A		8A		TOTAL SM-DIS		PCT-TOTAL	
	ACTNS	$(000)	ACTNS	$(000)	ACTNS	$(000)	ACTN	AMT	ACTNS	$(000)	ACTN	AMT	ACNS	$(000)	ACNS	$(000)	ACNS	$(000)	ACTN	AMT
TOTAL DOD																				
FY 79	3,405	200,666	.574	68,173	2,831	132,493	83.1	66.0	205	11,866	6.0	5.9	223	9,350	5	142	228	9,492	6.7	4.7
FY 80	3,148	194,204	490	56,608	2,658	137,596	84.4	70.9	729	40,415	23.2	20.8	282	12,357	18	1,924	300	14,281	9.5	7.4
FY 81	4,091	234,318	533	57,538	3,558	176,780	87.0	75.4	2,130	110,050	52.1	47.0	429	18,193	28	1,025	457	19,218	11.2	8.2
FY 82	5,299	313,815	501	71,730	4,798	241,455	90.5	77.1	3,812	182,291	71.9	58.1	609	25,035	34	689	643	25,724	12.1	8.2
FY 83	3,994	431,473	518	139,819	3,476	291,654	87.0	67.6	3,050	245,749	76.4	57.0	477	33,716	21	2,563	498	36,279	12.5	8.4
FY 84	4,327	413,147	542	106,909	3,785	306,238	87.5	74.1	2,899	223,637	67.0	54.1	489	35,602	16	1,668	505	37,270	11.7	9.0
FY 85	4,811	456,560	877	152,222	3,934	304,338	81.7	66.6	1,499	103,372	31.1	22.6	570	40,891	12	677	582	41,568	12.1	9.1
FY 86	4,041	384,243	891	136,257	3,150	247,986	77.9	64.5	733	49,308	18.1	12.8	372	28,506	10	523	382	29,029	9.4	7.6

1/ This table presents all A&E actions (minus R216 marine A&E) that are for construction (C2 in Item 10C) for work performed in the U.S. and its possessions.

Senator DIXON. Before I get to Ms. Fischer, I would like to follow up on something here.

A lot of people think that using SIC codes, with 1,100 different classifications, is going to be onerous.

Is there any alternative you would suggest that would be a better one for your classification, to avoid what I hear you saying to me, and so as to not go into this massive paperwork of 1,100 different categories that DOD, Energy, and other people have to deal with?

Mr. DEFRAITES. The Brooks bill procurement system is very precise in what it addresses.

If we could address that type of procurement as a category, it would meet our particular needs.

Senator DIXON. I wish you would talk to staff about that a little bit at some convenient time to develop that a bit further.

Mr. DEFRAITES. Certainly. I would be glad to speak to staff.

Senator DIXON. Thank you, Mr. DeFraites. We appreciate your comments.

Ms. Fischer, we await your testimony, please.

STATEMENT OF I. SHARON FISCHER, PRESIDENT, PRICELESS INDUSTRIES, INC., BALTIMORE, MD, REPRESENTING THE AMERICAN SUBCONTRACTORS ASSOCIATION

Ms. FISCHER. Mr. Chairman, my name is Sharon Fischer.

I am president and chief executive officer of Priceless Industries, a concrete construction firm in Baltimore.

Today I am representing the American Subcontractors Association, a national trade association with more than 7,000 firms, representing all major construction trades.

ASA's members have a direct and real interest in section 921 concerning small business set-asides. According to the ASA membership records, 80 percent of our members are small businesses, as defined by the existing size standards for specialty trade contractors.

Mr. Chairman, the heart of section 921 can be found in the provision that directed the reduction of size standards so that no more than 30 percent of the contracting opportunities would be subject to set-asides. The remaining 70 percent would be available for open competition.

The goal of those supporting this provision was to reduce the number of small business set-asides. They did this by reducing the number of "eligible 'small business firms.

The intended result was an insufficient number of small businesses to meet the set-aside opportunities.

This Rube Goldberg method of achieving a simple goal has had some unexpected negative results—results that ASA does not believe were taken into account by the proponents of section 921.

As an example, let's look at the impact on ASA members.

Under the existing SBA small business size standards, approximately 80 percent of our members are small businesses. These firms qualify not only for the procurement program, but also for a host of other small business programs made available through SBA.

These include the Surety Bond Guarantee Program and various loan and other financial assistance programs.

If the size standards proposed by SBA go into effect, only 15 percent of ASA members would be considered small businesses. That is, 4,550 companies that are now small businesses will suddenly no longer be small businesses. According to SBA, 50,000 firms may be in the same boat.

The new size standards are so low that almost across-the-board, firms eligible under the proposed size standards would be so small that their ability to handle a Government project within their specialty trade is questionable.

ASA does not believe this was the intent of Congress, and we urge you to assure that this does not occur.

The question remains, though, how can the goal of assuring small business participation be met?

We in the construction industry generally believe that, because of the nature of the industry and the size of the firms that comprise it, small business construction firms would be highly successful in the Federal market, even without the use of set-asides.

Given the large portion of contracting opportunities currently being set aside and the results of a recent ASA survey, we strongly believe our theory is correct.

Therefore, we urge you to reevaluate when it is necessary to use set-asides for construction.

We urge you to consider a program which would allow a contracting officer to use set-asides on a selective basis—when he must protect the market in which he is operating from the predatory activity of other than small firms.

It would be simple to determine the feasibility of this proposal.

We recommend that a Pilot Program be conducted in which a significant majority of the contracting opportunities below a fixed threshold are made available for unrestricted competition.

Careful records will need to be maintained with respect to small business success in these contracting opportunities.

If it is determined that other than small firms enter the market and undercut prices simply to win the contracts and eliminate their small business competitors, then the contracting officer should implement a Set-Aside Program in that market.

Otherwise, the market should operate freely.

Mr. Chairman, the adoption of section 921 has created a great deal of anxiety and confusion among construction specialty trade contractors. ASA has received dozens of phone calls from contractors who are concerned about whether they will continue to be eligible for small business programs, about whether they will still be able to serve as prime contractors or subcontractors on Federal construction, and just when the new rules will go into effect.

I urge you, Mr. Chairman, to take action as quickly as possible to relieve their concerns.

ASA stands ready to work with you and this subcommittee to improve the effectiveness of the procurement system and to increase participation in that system by all segments of the small business community.

Thank you, Mr. Chairman.

[The prepared statement of Ms. Fischer follows:]

Statement of

AMERICAN SUBCONTRACTORS ASSOCIATION

to the

SUBCOMMITTEE ON GOVERNMENT CONTRACTING
AND PAPERWORK REDUCTION

of the

COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

on

SECTION 921 OF PUBLIC LAW 99-661

September 15, 1987

AMERICAN SUBCONTRACTORS ASSOCIATION, INC.
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Statement on Section 921, Small Business Set-Asides, of the "Defense Acquisition Improvement Act of 1986"

The American Subcontractors Association is a national trade association with more than 7,000 firms representing all major construction trades in 55 chapters. In addition to its individual company members, ASA represents 15 other specialty trade associations with members of their own (See Appendix A).

ASA is the only national organization that speaks exclusively for the interests of construction subcontractors. ASA is dedicated to improving general business conditions for subcontractors through unified and cooperative actions.

The overwhelming majority of ASA members are small businesses. According to ASA membership records, 80 percent of our members are small businesses as defined by the existing size standards for specialty trade contractors. In addition, many ASA members perform construction for the federal government. Sometimes they serve as prime contractors, contracting directly with the federal government. More often, they serve as subcontractors, dealing with the government only through a prime contractor. Therefore, we have a direct and real interest in

Section 921, Small Business Set-Asides, of the "Defense Acquisition Improvement Act of 1986", Title IX of the "Department of Defense Authorization Act, 1987" (Public Law 99-661) and any resulting implementing regulations.

Introduction

It is ASA's understanding that the adoption of Section 921 was supported by many in both the private sector and those in Congress for two very different reasons.

First, many in the small business community and the House Committee on Small Business saw the provisions of Section 921 as an opportunity to broaden the range of small business participation in the federal procurement market. In the view of some, federal agencies do not expend the effort to increase small business participation in some market areas because they are able to meet their "small business goals" through attention to market segments where small businesses are the natural winners.

Other proponents of Section 921 supported its provisions in order to curtail the number of set-asides in industry categories in which they felt a disproportionate number of small business set-asides are found. This is particularly true of the various organizations that comprise the construction industry. Because of the nature of the construction industry and size of the majority of its firms, we in the construction industry generally believe that small business participation in the federal construction market can be achieved without set-asides. Indeed, many of the original proponents of Section 921 have strongly held views that all preferential procurement in the construction industry should be abolished.

But it is our view that we are not here today to address the philosophical merits of such arguments but to assess the practical workability of the modifications to the small business procurement programs made by Section 921. Thus, the focus of this statement is on the practical impact of what the Small Business Administration has done and may do in response to Congressional direction contained or perceived to be contained in Section 921. As the members of the Small Business Committee well know, the guidance contained in any SBA regulation ultimately will be translated into action by the procuring agencies. Their direction, in turn, all too often reflects a rigidity that can have results that go far beyond what SBA or even the Congress intended.

Similarly, we do not intend to critique the SBA report to the Congress. We have reviewed it carefully and see it as a tool to help this Committee assess the impact of this statute.

In that spirit, ASA would like to make some observations concerning individual provisions and suggest alternatives for attaining the objectives concerning the management of the procurement programs designed to assist small businesses in the federal procurement market.

Reduction of Size Standards

The heart of Section 921 can be found in the provision that directed the reduction of size standards for four designated industries such that no more than 30 percent of the contracting opportunities would be subject to set-aside and the remaining 70 percent would be available for open competition.

Those advocating this provision clearly believe that there are too many set-asides in these industries, which act to exclude firms that are other than small businesses as defined by SBA. We believe this is the result of the tendency of contracting officers to use the construction industry, which is predominantly small businesses, to meet a significant portion of its overall goals for small business participation within the agency or department.

What the proponents of Section 921 were seeking, in our view, was a limitation on set-asides. But, because of the natural adverse reaction that could be expected from other segments of the small business community to a direct cap on set-asides, the proponents chose to achieve their goal through indirection. Thus, their goal was to reduce the number of "eligible" small business firms so that the number of participants would shrink to the point to which they would no longer be available to meet contracting opportunities set-aside for exclusive competition as small businesses.

But this "Rube Goldberg" method of achieving a simple goal has had some unexpected results--results which ASA does not believe were taken into account by the proponents of Section 921.

Let's look, as an example, at ASA members. Under the existing SBA small business size standards, approximately 80 percent of our members are "small businesses".

As small businesses, these firms qualify not only for the small business procurement program but also for a myriad of other small business programs made available through SBA, including the Surety Bond Guarantee Program, and various loan and other financial assistance programs. Of course, not every firm takes advantage of every program. Indeed, most firms probably never take advantage of any of these programs. But the programs are there when needed. And many, many firms that believe they will never need such a program find themselves using them when they experience a business calamity, such as a market change or financial crisis.

If the size standards proposed by SBA were to go into effect, only 15 percent of ASA members would be considered small businesses. That is, 4,550 companies that are now small businesses will no longer be eligible for a myriad of small business programs. According to SBA, 50,000 firms may be in the same position.

ASA believes that the drastic reduction in size standards proposed by SBA in the specialty contracting area is largely the result of the procuring agencies' tendency to use set-asides liberally in the construction industry in order to avoid the gamble that a small firm might not win in open competition. Almost across-the-board, firms eligible under the proposed size standards would be so small that their ability to handle a government project within their specialty trade, particularly as a prime contractor, would be questionable.

ASA does not believe this was the intent of Congress and we urge you to assure that this does not occur.

The question remains, however, how can the goal of assuring small business participation be met?

As stated above, we in the construction industry generally believe that, because of the nature of the industry and the size of the firms that comprise it, small business construction firms would be highly successful in the federal market even without the use of set-asides on a routine basis. This belief was reinforced by the results of a survey conducted by ASA in March of this year.

The results of the survey indicate that the smaller the specialty trade contractor, the more likely it is to perform some federal construction (See Appendix B). For example, 73.8 percent of the firms with annual volume of less than $500,000 perform federal construction; 55.3 percent of the firms with annual volume between $2 million and $5 million perform federal construction; but only 28.6 percent of the firms with annual volume over $25 million perform federal construction.

Undoubtedly, a part of this disparity is the result of programs encouraging small business participation in federal procurement. But we do not believe that to be entirely the case for two reasons. First, the breaking point for higher participation in the federal market is not at the $7 million definition for small business of a specialty trade contractor. In addition, the amount of federal construction, as measured by a percentage of annual sales volume of those that perform federal construction, did not differ significantly among the range of company sizes. In each case, it averaged about 15 percent of annual sales volume.

ASA suggests that the Committee consider the adoption of a program which would allow a contracting officer to use set-asides on a selected basis--when he must protect the market in which he is operating from the predatory activity of other than small firms.

We believe the feasibility of such a program could be determined by conducting a pilot program in which a significant majority of the contracting opportunities below a fixed threshold were made available for unrestricted competition. Careful records would need to be maintained with respect to small business success in these contracting opportunities. If it is determined that other than small firms enter the market and undercut prices simply to win the contracts and eliminate their small business competitors, then the contracting officer should implement a set-aside program in that market. Otherwise, the market should operate freely.

Limitations on Subcontracting

Section 921 also established a 50 percent rule, which prohibits a federal prime contractor from subcontracting more than 50 percent of a contract obtained through a set-aside. We understand that the objective of this provision was to deal with so-called "front" companies.

However, Congress also recognized the special situation that exists in the construction industry. In the entire industry--not just the segment that deals with government--subcontracting is the rule rather than the exception. It is the way the work gets done. On most federal construction, the prime contractor performs no more than 20 percent of the work. As much as 80 percent is performed by trade contractors with the special skills and knowledge of plumbing, air conditioning, electrical, roofing, drywall, painting, flooring, and literally dozens of other trades.

In implementing this provision, SBA must make sure it gives recognition to the reality that subcontracting is the norm in the construction industry. A rigid adherence to a 50 percent subcontracting limitation in construction would be disruptive of the industry's regular practice.

Disclosure of Competitors

Section 921 would require the contracting officer to disclose to "any person" the identity of small firms he intends to solicit during the conduct of a procurement limited to the exclusive participation of eligible small business firms. It appears to ASA that this provision is another indirect effort to address an issue that could not be addressed directly--the use of the so-called "rule of two" by contracting officers in making a determination of whether a contracting opportunity should be set-aside.

ASA, like most others in the construction industry, has serious concerns about the rigidity in the "rule of two". However, we believe the disclosure rule in Section 921 could lead to the routine challenge of the eligibility of small firms by other than small firms who are unhappy with the decision to set-aside a contract for exclusive small business participation. The potential for delays in both solicitation and award is real.

We suggest that the problems surrounding the "rule of two" be addressed more directly, and that we avoid the detrimental side-effects of this solution by indirection.

Conclusion

The enactment of Section 921 has created a great deal of angst and confusion among construction specialty trade contractors. ASA has received dozens of phone calls from contractors who are concerned about whether or not they will continue to be eligible for small business programs, about whether they will still be able to serve as prime contractors or subcontractors on federal construction, and just when the new rules will go into effect.

Therefore, ASA urges this Committee to take action as quickly as possible to relieve their concerns.

ASA's comments on this matter have been constructive. We stand ready to continue to work with this Committee to improve the effectiveness of the procurement system and to increase participation in that system by all segments of the small business community.

Appendix A

American Subcontractors Association National Associations' Council Members

ADSC: The International Association of Foundation Drilling Contractors

American Architectural Manufacturers Association

American Institute of Steel Construction

Architectural Precast Association

Association of the Wall & Ceiling Industries - International

Ceiling and Interior Systems Construction Association

Concrete Sawing & Drilling Association

Institute of the Ironworking Industry

Insulation Contractors Association of America

National Association of Elevator Contractors

National Glass Association

National Ornamental & Miscellaneous Metals Association

National Roofing Contractors Association

Painting and Decorating Contractors of America

Appendix B

American Subcontractors Association
Survey on Federal Construction*

Question #1:
Do you perform work on federal construction projects?

Yes: 62.7%
No: 37.3%

Question #2:
What is your approximate annual sales volume?

Annual Volume	Total Respondents	Respondents Who Perform Federal Construction	Respondents Who Do **Not** Perform Federal Construction
Less than $500,000	13.2%	73.8%	26.2%
$500,000-$2 million	36.8%	71.4%	28.6%
million-$5 million	27.3%	55.3%	44.7%
$5 million-$10 million	12.3%	56.8%	43.2%
$10 million-$25 million	8.2%	48.0%	52.0%
Over $25 million	2.2%	28.6%	71.4%

Question #3:
What percentage of your annual sales volume is on federal construction?

Range:	00.01%-90%
Mean:	18.8%
Median:	15%
Mode:	10%

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* Methodology: A survey questionnaire on federal construction practices was sent by the National Office of the American Subcontractors Association to 1,000 construction subcontractors randomly selected from its membership list on March 27, 1987. The completed forms were returned to the ASA National Office between April 3 and April 17, 1987. Completed questionnaires were returned by 322 of the 1,000 members to which the survey was distributed, representing a 32.2 percent response rate.

Senator DIXON. Thank you, Ms. Fischer.

Basically, a good deal of your testimony was based on the 30 percent rule concerns that your industry has. Is that not true?

Ms. FISCHER. Yes, sir.

Senator DIXON. And you understand, do you not, that we really do not address that in S. 1559 here?

We understand the concern, and we are very much troubled by considerable difficulty out there as a consequence of it. It may even be that I will talk to some of my colleagues about whether some further consideration of an additional time period to try to review it would help.

But I noticed that Ms. Williams also had suggested, as you do, some kind of test programs to see whether we can observe a Pilot Program that would help us come to a conclusion.

Do you think that might be valuable?

Ms. FISCHER. We highly recommend it and we will do anything that we can to help implement it.

Senator DIXON. I am told that we are considering, in the Committee on Governmental Affairs, a program along these lines. I will assure you that I will personally observe that and become familiar with it and will follow that very closely as a part of the process of what we are trying to do here. I am not unmindful of your concerns, may I say.

Do I correctly get the impression that both of you have no problem with keeping the "fair and reasonable" price as a rule of the marketplace?

What about the no disclosure of bidders prior to award? Is it true that you would rather not see that changed?

Ms. FISCHER. Are you referring to bid listing?

Senator DIXON. Yes.

Ms. FISCHER. We would prefer it.

Senator DIXON. Would you prefer that the law be changed in that regard and that the provisions in section 921 be adopted?

Ms. FISCHER. No.

I am not saying that we would prefer that the law be changed. We would prefer the bid listing as standard practice against unfair practices in our own industry. But to say that we would like the Government to mandate it, yes.

Mr. DEFRAITES. We don't have a particular problem with that because in our particular procurement process, we use the 254–255 forms for setting out our qualifications. When we do this, we list all of the associates and subcontractors that the architect/engineer would have going in.

So the procurement officer does not have a problem in knowing who these people are going to be because our qualification packages are based upon the combined strength of all of the firms that put their information together.

So it is not a particular problem for us.

I can see where it is a problem for the contractors who are trying to bid work that we would be supervising. And if we are involved in any of that type of supervision activity, that could be a potential problem.

Of course, I would suspect that the main reason for the listing is bid shopping, which all of us, as engineers, are constantly involved in, in the problem where all of a sudden you have a new subcontractor that you never heard of who has a price that is lower than anybody else's, and you have problems that evolve.

But, from the A/E professional point of view, we have no particular problem with that provision because of the way we structure our activity.

Senator DIXON. I thank you very much. Both of you have been very helpful.

We appreciate your contributions.

Mr. DEFRAITES. Thank you very much, Senator.

Ms. FISCHER. Thank you, sir.

Senator DIXON. Thank you very much.

Our final panel consists of Mr. William D. Fletcher, president of Florida Dredge and Dock in Clearwater, FL. He will be accompanied by his counsel, J. Gordon Arbuckle. We also have Mr. Leon B. Monk, the president of South Atlantic Dredge Co., in Charleston, SC, accompanied by Karl Luedtke, the president of Luedtke Engineering Co. in Frankfort, MI.

Mr. Fletcher, would you please proceed.

STATEMENT OF WILLIAM D. FLETCHER, PRESIDENT, FLORIDA DREDGE & DOCK, INC., CLEARWATER, FL

Mr. FLETCHER. Mr. Chairman, Mr. Arbuckle is not with me today.

As you know, I am the president of Florida Dredge and Dock, Inc., which is a small dredging company located in Clearwater, FL.

My firm has been in business for about 8 years, with gross annual receipts of $1 million to $1.5 million.

As you may know, the current size standard for the dredging industry is $9.5 million. This size standard not only permits firms almost nine times my size to compete against me for small business set-aside contracts, but is also two to three times greater than the average size of the small firms in the dredging industry.

I think it is obvious that something must be done to lower the dredge size standard.

My company would welcome the opportunity to participate more in the SBA Set-Aside Program. However, we have been unable to compete effectively in our area for three reasons.

First, the excessively high size standard permits firms that I consider to be mid-sized to compete for set-aside work.

Second, the Corps of Engineers has tended to lump smaller projects into larger contracts, which are more difficult for us to bid on successfully against these mid-sized firms.

Third, the corps sets aside a large percentage of the contracts in our area. Therefore, the mid-sized firms have a substantial protected market, where they face very limited competition.

Senator DIXON. Why would that be, Mr. Fletcher?

Is it just people they have always done business with?

Mr. FLETCHER. That's my feeling on it. And I think one of the reasons why is the corps tends to lump projects together to create a larger procurement that allows them to deal with companies that are 9 or 10 times my size. It's not that I could not do the work if they would separate it, but they put time restrictions in and stuff like that on it that I just cannot meet with my equipment. So that just eliminates us from that set-aside work.

The mid-size firms do so well, in fact, that they can often outcompete the big dredging companies in unrestricted procurements.

It is unfair for the large dredging companies to be deemed small and thereby dominate the Government dredging market to the detriment of the small emerging firms.

Section 921 was a definite improvement.

I hope the Congress and SBA will work to make the new amendments and their implementation effective.

I have four suggestions that might help.

First, a firm which is dominant in its field of operations should not be considered small. The D.C. District Court so held in its recent California Dredging Decision, striking down the SBA's 1985 decision to increase the dredging size standard from $9.5 million to $13.5 million.

The court noted that the SBA itself, in its 1984 profile of the dredging industry, recognized the regional nature of the industry and concluded that the inland and Great Lakes regions have patterns of dominance suggesting that a lower size standard would be appropriate, given that dominant firms in the region were already defined as small.

For the Subcommittee's information, I have attached charts from the SBA's "Profile" and charts of my own to depict firm dominance.

The court held that when, as in dredging, most of the firms in an industry are regarded as being confined to a regional market by geographical and financial considerations, the small business size standard cannot be one that gives a dominant firm in a regional market the preferred status of a small business.

A second important ruling in the case was to remand the dredging size standard issue to the SBA for further review. To comply with the court's directive, the SBA should have analyzed the dredging industry by its geographical markets.

The SBA's July 1987, report to Congress failed to do this.

Second, there must be a fair proportion of set-asides, but also a substantial area of open competition in every relevant market. Small business must have an incentive to go after set-aside work. Once they are successful and grow, there must be enough work for them to pursue in an open market.

Without this incentive, firms will hover for years just under the size standard and dominate the small business set-aside market, as shown on my chart on set-aside activity in the southeast.

Section 921 has helped. First, it requires that a fair proportion of contracts be awarded to small business in each industry category.

Second, it provides a mechanism to open competition to roughly 70 percent of the contracts.

I would oppose the provisions of S. 1559 that would revert to calculating fair proportion on a governmentwide basis.

Third, the current 30 percent rule is too crude an enforcement mechanism.

I believe instead that, one, the 30 percent is more appropriate as a goal for total small business participation; and, two, size standards should be determined based on market analysis.

A real injustice—obviously contrary to the act—would result if dominant firms continue to be classified as small, merely because the percentage of set-asides in a given industry has failed to reach a specified level.

Fourth, in determining which contracts to set aside, it is important that agencies set aside small contracts first.

Setting aside smaller contracts would give maximum assistance to truly small businesses and be easier to administer.

As I have stated, it does a small company like mine little good if the court sets aside lots of $3 million to $4 million contracts or lumps several smaller contracts into one large one.

In closing, I think section 921 contains basically good amendments. The SBA did a pretty good job in analyzing most of its provisions and I am pleased that it found all but one of the provisions advisable and feasible.

Some more guidance is needed, however, for the SBA to implement section 921 to benefit truly small firms, such as ours.

Specifically, the SBA has yet to honor the court's order in California Dredging to review and establish a dredging size standard that is low enough so that firms which are dominant in their markets are not deemed small.

The agency should proceed to collect complete dredging contract award data and conduct another review based on equivalent and geographical considerations, as contemplated in all provisions of the Small Business Act, not just those added by section 921.

Thank you.

[The prepared statement of Mr. Fletcher follows:]

Testimony
of
WILLIAM D. FLETCHER, PRESIDENT
FLORIDA DREDGE & DOCK, INC.
before the
Subcommittee on Government Contracting
and Paperwork Reduction
of the
Senate Committee on Small Business
September 21, 1987

Mr. Chairman, members of the Committee, my name is William us Fletcher. I am President of Florida Dredge & Dock, Inc., a small dredging company located in Clearwater, Florida. My firm has been in the dredging business for 8 years now, with gross annual receipts between $1-1.5 million.

I. Introduction

As you may know, the current size standard established by the Small Business Administration (SBA) for the dredging industry is $9.5 million in gross annual receipts. This size standard not only permits firms almost 9 times my size to compete against me for small business set aside contracts, but it is also 2 to 3 times greater than the average size of small firms in the dredging industry. Consequently, it has long been my opinion that something must be done to lower the dredging size standard. To do this requires a more equitable method of establishing all size standards. In the hope of achieving this goal, I have been involved for several years with an informal coalition of other small and larger dredging companies, called the Dredging Industry Size Standard Committee (DISSC).

My company would welcome the opportunity to participate more in the SBA's set-aside program. However, we have been unable to compete effectively in our area for three reasons. First, the excessively high size standard permits very large "small" firms to compete for set aside work. Second, the Corps of Engineers (which provides most of the work in the dredging industry) has tended to aggregate smaller projects into larger contracts which are more difficult for us to bid on successfully against those large "small" firms. Third, the Corps sets aside a large percentage of the contracts in our region. Therefore the large "small" firms have a substantial protected market where they face very limited competition. They do so well, in fact, that they can often out compete the big dredging companies in unrestricted procurements.

It is unfair for the large dredging companies to be deemed "small" and thereby dominate the government dredging market to the detriment of the small, emerging firms. Yet, I am told that the small business set aside program was created to help firms like mine. The recently enacted amendments to the Small Business Act contained in Section 921 of Public Laws 99-591 and 99-661 were a definite improvement. Now, I hope, the Congress and the SBA will work to make the new amendments and their implementation effective. I have some specific suggestions that might help.

II. Recommendations for a More Equitable Set Aside Program

First, I would like to give you a little background on our efforts in this area. Before I joined the coalition efforts of

DISSC, the group had petitioned the SBA in 1979 to lower the dredging size standard to a level that would provide meaningful assistance to emerging dredging firms. I first participated in DISSC's efforts when I testified in Congressional field hearings in Atlanta, Georgia in 1980. Other members of our group testified before SBA and the Congress on several occasions. Finally in 1984 the SBA decided to conduct a more thorough review of the dredging industry and published a comprehensive profile of the industry. [1/] Then, in a subsequent rulemaking in 1985, the SBA came out with an increased size standard of $13.5 million! Our dredging coalition challenged that decision in court and won. The court found that SBA had failed to analyze sufficiently the geographical markets in which small dredging firms compete and to establish a size standard that would not classify as "small" firms that are dominant in their relevant markets. The court concluded that the SBA had failed to adhere to its legislative mandate, namely assisting truly small firms. Now, once again we find ourselves appearing before Congress to urge enforcement of the Act's and the court's mandate. We have identified the following areas for your consideration.

[1/] Small Business Administration, Profile of the Dredging Industry for the Purpose of Setting a Size Standard (June 4, 1984).

1. A FIRM WHICH IS DOMINANT IN ITS FIELD OF OPERATION SHOULD NOT BE CONSIDERED "SMALL"

The Small Business Act defines a "small business concern" as "one which is independently owned and operated and which is not dominant in its field of operation."[2/] Under this definition, a small business should not be dominant in its relevant market. The District Court for the District of Columbia so held in its recent decision striking down the SBA's 1985 decision to increase the dredging size standard from $9.5 to $13.5 million.[3/] The court noted that the SBA itself in its 1984 Profile recognized the regional nature of the industry and "concluded that the Inland and Great Lakes regions have patterns of dominance suggesting that a lower size standard would be appropriate", given that dominant firms in the region were already defined as small."[4/] For the Subcommittee's information, I have attached charts from the SBA's Profile and charts of our own that depict firm dominance (Attachments II and III). The court held that when, as in dredging, "most of the firms in an industry are regarded as being confined to a regional market by geographical

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[2/] 15 U.S.C. § 632(a)

[3/] California Dredging Co. v. Sanders, Civil Action No. 85-3906, (D.C.D.C. November 3, 1986) (Attachment I).

[4/] Id. at 6 (quoting SBA's report entitled Profile of the Dredging Industry for the Purpose of Setting a Size Standard, June 4, 1984 at 10) and financial considerations, the small business size standard cannot be one that gives a dominant firm in a regional market the preferred status of a small business."[5]

A second important ruling in this case was to remand the dredging size standard issue to the SBA for further review. To comply with the court's directive, the SBA should have analyzed the dredging industry by its geographical markets. It then should lower the current $9.5 million size standard if that standard permits a dominant firm in a regional market to qualify as "small."

I am deeply disappointed that the SBA's July 1987 report to the Congress ignored not only the court, but also the Congress by refusing to analyze the percentage of dredging set-asides in each geographical market and the dominance of certain so-called "small" firms in some of those markets. The legislative history of section 921 points out that:

> . . . the dredging industry is not as homogeneous as SBA believes and the agency should pursuant to this bill segment further that market based upon equipment needs.[6]
>
> * * *
>
> The bill also requires segmentation on the basis of geographic considerations. . .[7]

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[5] *Id.* at 8

[6] 132 Cong. Rec. H 10140 (daily ed. Oct. 15, 1986) (Statement of Cong. Mitchell).

[7] *Id.*

It could not be made any more clear that the SBA must conduct both a geographic market analysis and a competitive analysis of the dredging industry to arrive at an appropriate size standard. The SBA cannot simply determine, as it has in its recent proposed rule, that firms falling within the present size standard are automatically deemed not to be "dominant in their field of operation."8/ This proposal amounts to an administrative repeal of the statutory requirement regarding dominance, because it would pronounce firms under $9.5 million not dominant in their market of operation when they clearly are. Again, I refer the Subcommittee to the charts in Attachments II and III of my testimony.

2. THERE MUST BE A FAIR PROPORTION OF SET ASIDES, BUT ALSO A SUBSTANTIAL AREA OF OPEN COMPETITION, IN EVERY RELEVANT MARKET

Based on my experience in the Southeast, there should be enough set aside contracts of the size small firms can perform, and the balance of the work should be open to unrestricted competition. Small businesses must have an incentive to go after set aside work so they can enter the government market successfully. Then, when those firms grow, there must be enough work for them to pursue in the open market. Otherwise, without

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8/ 52 Fed. Reg. 32870, 32872 and 32885 (August 31, 1987).

an incentive to grow, firms will hover for years just under the size standard and dominate the small business set-aside market as shown in my chart on set-aside activity in the Southeast (Attachment III).

Again, you can see the link between size standards and proportion of set asides. An excessively high size standard discourages small market entrants unable to compete with the much larger firms that qualify as "small" for set aside work. And, an excessively high proportion of set aside work discourages small firm graduation. So it is absolutely critical to ensure a substantial area of open competition in every procurement market to provide small firms the incentive to grow.

I believe the recent Small Business Act Section 921 amendments accomplish these goals in two ways. First, they require that a fair proportion of contracts be awarded to small business in each industry category. Second, they provide a mechanism to open competition to roughly 70 percent of the contracts in each industry category.

Our group supports these important changes and would oppose the provision of section 2 of S. 1559 that would revert to calculating fair proportion on a government-wide basis. This provision would put us back in the unfortunate situation where government agencies meet their overall set-aside goal by targeting a few industries for the lion's share of set-aside contracts.

As an alternative, I would recommend that each agency try to ensure that the small businesses in a particular industry category receive a fair proportion of the government's requirements in that industry category. The "fair proportion" goal should be set at a level which the procuring agencies find to be realistically attainable for all industries. It is important to note that "small business participation" is not just minority and non-minority set-aside awards but also includes awards in open competition, small purchases and subcontract awards. So, to determine an appropriate goal for "small business participation," the SBA should look at all of these small business procurement data. It would also help if, for example, the Corps would target its procurements in an effort to award a fair proportion of its contracts in each geographical region to small businesses. Since the SBA recommended a "goaling" approach in its recent study as both desirable and feasible, I hope the method I suggest will be considered.

3. THE CURRENT 30 PERCENT RULE IS TOO CRUDE AN ENFORCEMENT MECHANISM.

Implicit in the recent amendments is that there should be a goal for small business' fair proportion of government work, and that at least 70 percent of the all contracts should be awarded on an unrestricted basis. Those concepts I like. I am not as supportive of a 30 percent rule that permits a size standard reduction triggered only when 30 percent of the contracts in that industry are set aside. I believe, instead, that (1) the 30 percent is more appropriate as a goal for total small business participation and (2) that size standards should be determined based on analysis of the competitive characteristics of the markets in that industry so that firms dominant in any such market cannot qualify as "small." A real injustice -- obviously contrary to the Act -- would result if dominant firms continue to be classified as "small" merely because the percentage of set-asides in a given industry has failed to reach a specified level.

4. IN DETERMINING WHICH CONTRACTS TO SET ASIDE, IT IS IMPORTANT THAT AGENCIES SET ASIDE SMALL CONTRACTS FIRST.

Setting aside smaller contracts would serve the twin goals of maximum assistance to truly small businesses and of administrative simplicity. As I have stated, it does a small company like mine little good if the Corps sets aside lots of $3-$4 million contracts, or aggregates several smaller contracts into one larger procurement. Therefore, it is essential to award contracts in a manner that facilitates performance by those companies which the Small Business Act is designed to assist.

As to administrative simplicity, it would be easier for an agency to meet the fair proportion goal by working from the smallest contract on up. Whether by set aside or otherwise, the agency could reserve enough contracts for small businesses to meet the agency's fair proportion goal for that industry, and then award the rest of its contracts on an unrestricted basis.

5. IT IS IMPORTANT TO PROVIDE THE PROTECTION TO SMALL BUSINESSES AFFORDED BY THE "FAIR MARKET PRICE" PROVISION.

Another important amendment in Section 921 is the "fair market price" provision. Smaller firms need some protection from larger "small" firms that have greater overhead flexibility to bid below cost on contracts. Firms that engage in such predatory pricing practices eventually can drive smaller competitors out of business.

With the "fair market price" provision, there are objective criteria a contracting officer may use to judge bids. Bid prices can be compared not only with the government's estimate of the cost of the work required, but also with prices that could be obtained in open competition. The contracting officer also will be able to view a particular bid as too low to be realistic or in the best long-term interests of the government.

For these reasons, our group favors the fair market price language contained in existing law, and strongly disagrees with the approach taken in S. 1559 to reinstate the more ambiguous "reasonable" price standard.

* * *

In closing, I wish to stress that Section 921 contained basically good amendments to the Small Business Act. I think the SBA did a pretty good job analyzing most of its provisions, and I am pleased that it found all but one of the provisions advisable and feasible. Some more guidance is needed, however, for the SBA to implement Section 921 to benefit truly small firms.

Specifically, the SBA has yet to honor the court's order in California Dredging to review and establish a dredging size standard that is low enough so that firms which are dominant in their market are not deemed "small." The agency should proceed to collect complete dredging contract award data and conduct another review based on equipment and geographical considerations as contemplated in all provisions of the Small Business Act, not just those added by Section 921.

In addition, steps must be taken to ensure that there will be a fair proportion of both set-aside and competitive contract activity in each relevant market. This is the only way small firms will have adequate incentive to grow and compete in open competition. I believe some guidance from the Congress would help in this area. I also think the Congress should reassess the linkage between size standard adjustment and a particular percentage of set-aside activity in a given market. Market dominance analyses should be SBA's primary focus in determining size standards. In short, I support the basic concepts established in existing law, provided certain modifications are made in the way SBA implements its Congressional mandate.

Thank you.

Attachments

Attachment 1

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA DREDGING CO., ET AL., Plaintiffs.)
v.)   Civil Action No. 85-3906
JAMES C. SANDERS, ET AL., Defendants.)

MEMORANDUM

In this proceeding the Court is asked to declare invalid a regulation, 13 C.F.R. § 121.2 (1986), issued by the Small Business Administration ("SBA"), defining what constitutes a small business in the dredging industry eligible for favorable governmental procurement consideration under the pertinent provisions of the Small Business Act ("Act"), 15 U.S.C. §§ 631 et seq. (1982 & Supp. III 1985). Plaintiffs, a number of large and small dredging companies, contend that the regulation is arbitrary, capricious and contrary to law. The administrative record was filed and subsequently cross-motions for summary judgment have been briefed and argued. The basic facts describing the dredging industry on which SBA relied are not in dispute but the appropriateness of its small-business standard is sharply challenged.

The Small Business Act reflects the congressional purpose to promote competition in the economy.[1] The Act is designed to encourage competition by enhancing the ability of small businesses to compete against larger concerns, through preferential set-asides on government contracts as well as loans and other assistance.[2] The Act defines "a small-business concern" as "one which is independently owned and operated and which is not dominant in its field of operation." It charges SBA with "making a detailed definition" of small businesses, based on the "dollar volume of business" and other criteria. 15 U.S.C. § 632(a). Pursuant to this statutory mandate, SBA has determined that size standards will "vary by industry with particular attention to the structure of the designated industry, Administration policy and the needs of the various Federal programs to which they apply," and has identified a number of specific factors it will consider.[3]

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[1] The Act is grounded on the view that "[t]he essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation." 15 U.S.C. § 631(a).

[2] See 15 U.S.C. §§ 636 to 638. The Act states that to promote the "security and well-being" of the nation, "[i]t is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns," id. at § 631(a). In 1980 Congress reaffirmed that, "[f]or the purpose of preserving and promoting a competitive free enterprise economic system," it is "the continuing policy and responsibility of the Federal Government" to work to "foster the economic interests of small businesses; insure a competitive economic climate conducive to the development, growth and expansion of small businesses; establish incentives to assure that adequate capital and other resources at competitive prices are available to small businesses; reduce the concentration of economic resources and expand competition; and provide an opportunity for entrepreneurship, inventiveness, and the creation and growth of small business." Id. at § 631a(a).

This latest size standard for the dredging industry arose out of a comprehensive SBA review of existing size standards for all industries that commenced in March 1980. See 45 Fed. Reg. 15,442 (1980). After lengthy proceedings SBA decided to retain most of the size standards, adjusting for inflation since 1975 when they were last updated, but including other alterations for some industries. See 49 Fed. Reg. 5,024 (1984).

SBA withheld decision, however, on the appropriate size standard for the dredging industry because it found "deep polarization within the industry." It noted that of the dredging firms that submitted comments, 28 favored a standard lower than the then-current size standard, which defined as "small" any dredging firm with gross annual revenues of $9.5 million or less, and 12 desired an increase reflecting a full adjustment for inflation. These 40 responses accounted for approximately one quarter of the firms in the industry. SBA ultimately announced that it would retain the $9.5 million size standard pending further review. See id. at 5,025-26; see also 49 Fed. Reg. 47,412-13 (1984). After agency investigation and further comment by interested parties, SBA issued a Proposed Final Rule on December 4, 1984 raising the dredging size standard to $13.5 million, an increase of 40% and one matching the increase in the size standard SBA had found appropriate for several general construction industries which present considerably different questions for analysis. See 49 Fed. Reg. 47,412-13 (1984). Following further comment by interested parties, on November 8, 1985, SBA adopted the regulation challenged here. See 50 Fed. Reg. 46,418 (1985).

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[3] See 13 C.F.R. § 121.1(b). These factors include "maximum size of firms, average firm size, the extent of industry dominance by large firms, the number of firms, the distribution by firm size of sales and employees in the industry, the presence of Federal procurement, and relation to other SBA programs." The regulation indicates that "[t]he development of size standards is not an exact quantitative procedure" and that "[n]o single measure or simple numerical device is the basis for establishing size standards." Id.

In work leading to issuance of the proposed rule, SBA's Size Standards Staff conducted a comprehensive review of the general nature of the dredging industry and of various factors it deemed relevant to setting a size standard. See Profile of the Dredging Industry for the Purpose of Setting a Size Standard, June 4, 1984 ("Profile") (Attachment 7 to Complaint). In its Profile, SBA recognized the existence of regional markets in the industry. It explained that "[d]redging is inherently limited to regional operations because the cost of transporting a dredge from region to region limits the ability to bid outside of a particular region."[4] As a result, it found that "regional as opposed to national markets have developed and the [Army] Corps

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[4] Profile at 9. In support of this statement, SBA noted that "Table 3 in the appendix illustrates this phenomenon with only a few of the dominant firms being active in a major way in more than one market." Id.

[of Engineers] tends to set aside contracts based on the availability of small firms to bid on contracts within each region," id. at 7-8.

In reviewing the level of concentration in the dredging industry as one of six factors analyzed,[5] SBA concluded that viewed on a national level "dredging tends to be dominated by a few large firms to a greater extent than occurs in most other industries in construction." Id. at 9. It noted that ordinarily this would suggest the need for a higher size standard to give more small firms assistance against the industry giants. See id. But when SBA analyzed the industry within the regional markets it had defined, it observed wide variance in the market power of "small" dredging firms. SBA noted that in 1983, 22.4% of federal dredging dollars were for contracts set aside for small firms. Yet the percentage of set-aside dollars varied widely by region. In three regions it was low: Gulf (2.4%), Northeast (7.5%) and Pacific (12.2%). In the Great Lakes region, it was somewhat higher (35.5%). It was considerably higher in the Inland (50.4%) and Southeast (59.6%) regions. See Profile at 7. SBA stated that these differences stem largely from differences in the scale of the work typically performed in each region.[6]

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[5] For the other factors examined, see supra note 3.

[6] SBA accounted for these differences as follows: "The reason for the continuing pattern of set-aside in the Southeast and to a lesser extent in inland areas is that these areas have work which can typically be performed by small firms. Dredging jobs are often set-aside based on the type of equipment required to perform a job. Heavy equipment jobs requiring hopper and dustpan dredging equipment must be unrestricted because small firms do not have this type of equipment. Deep water jobs and those

Based on this information and information contained in Table 4 of the Appendix to the Profile, documenting by region the share of each firm operating in the region, SBA concluded that the Gulf Coast and Northeast regions "have patterns of dominance suggesting that a higher size standard would be appropriate" because procurement there has "clearly been dominated by three or four firms and these firms are each large." Id. By contrast, it concluded that the Inland and Great Lakes regions "have patterns of dominance suggesting that a lower size standard would be appropriate," given that dominant firms in that region were already defined as "small." Id. at 10. SBA ultimately determined that the relatively high level of national concentration in the dredging industry should be disregarded for purposes of setting a size standard, because analysis of the experience in different regions produced "indeterminate results."[7]

SBA's Profile, which formed the basis for the final dredging size standard,[8] demonstrates that the regulation fails

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requiring very large operations are seldom set-aside. Contracts which must be performed in a short period of time are also usually unrestricted. Those types of jobs appear less often in the Southeast and Inland regions of the country than in other regions, and thus, more contracts can be set aside." Id.

[7] Profile at 10. According to SBA, analysis of regional patterns provided "no clear guidelines to the revision of the size standard," id. This statement, however, was made in the context of the agency's desire to establish a single standard of nationwide applicability — a desire not supported under the Act by the administrative record.

[8] See 49 Fed. Reg. 47,412-13 (1984).

to satisfy statutory requirements. At the time SBA conducted its analysis, even the existing $9.5 million size standard defined as "small" at least six firms that are dominant within their regional market. Table 4 in the Appendix to the Profile documents the full range of regional small-firm dominance. In the Inland region, the largest and fourth-largest firms were defined as small. In the Great Lakes region, the third- and fourth-largest firms were small. In the Southeast region and the Pacific region, the fourth-largest firms were small.[9]

SBA clearly assumes that the four largest firms in any region must be considered dominant and thus appropriately classified as "large." In suggesting that a higher size standard would be desirable in the Gulf Coast and Northeast regions, it stated that it "would be cautious not to raise the size standard to a level at which any of the four dominant firms in that particular region would qualify as small."[10] And by suggesting that the "patterns of dominance" in the Inland and Great Lakes regions call for a lower size standard, id. at 10, SBA necessarily indicated that it considers the leading small firms dominant in those regions. But the Act definitely requires that a small business must be one "which is not dominant in its field of operation." 15 U.S.C. § 632(a). When squarely faced with this dilemma, SBA simply noted without explanation that it "has never considered varying the size standard on a regional basis as a viable alternative to a nationwide size standard." Its failure to do so in this case without rational explanation is arbitrary and an error of law.[11]

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[9] Additionally, in the Inland region firms 5, 9 and 10 are small; in the Great Lakes region firms 5 through 10 are small; and in the Southeast region firm 8 is small. The heavy percentage of set-asides recorded in these regions is unsurprising given that when a number of small firms are available in a region, federal procurement regulations require that a contract be set aside if the contracting officer reasonably expects that responsive bids at reasonable prices will be received from two responsible small businesses. See 48 C.F.R. § 19.502-2 (1985).

[10] Profile at 9. Obviously, it may be that other firms currently defined as "small" should also be considered "dominant" within their region; for example, the fifth-largest firm in the Inland region has 8.5% of the business, more than half the share of the largest firm (with 15.3%). See Appendix to Profile, Table 4, at 2.

The Act does not specify that dominance is to be measured on a national scale and SBA may not limit its inquiry to promulgation of uniform national standards merely for convenience or because this approach may appear appropriate in the vast majority of cases. When most of the firms in an industry are regarded as being confined to a regional market by geographical and financial considerations, the small-business size standard cannot be one that gives a dominant firm in a regional market the preferred status of a small business.

In sum, SBA has failed to engage in rational rulemaking designed to ensure that the mandate of the Small Business Act is carried out in the dredging industry. Given the purposes of the

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[11] SBA did indicate that the patterns of dominance in the Inland and Great Lakes regions "are not reassuring" to it and that it "would prefer that its assistance be focussed on firms which are not dominant in markets." Profile at 10. SBA's work in defining small businesses, however, is not a matter of preference; SBA is obliged to ensure that under the statute businesses which are dominant in their field of operation are not considered "small."

Act previously reviewed, SBA cannot avoid its responsibility by dismissing considerations of dominance as "indeterminate" and refusing without explanation to consider the realities of competition in the regional markets it has found most truly reflect the competitive environment Congress has charged it to enhance by aiding small business.

The regulation must be enjoined and the matter remanded to SBA for further consideration in the light of this memorandum. Since the previous $9.5 million size standard is not challenged here, it remains in effect. Other procedural and substantive issues raised by plaintiffs' papers or during argument need not be considered. An appropriate Order is attached.

Gerhard A. Gesell
UNITED STATES DISTRICT JUDGE

November 3 , 1986.

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

CALIFORNIA DREDGING CO., ET AL.,)
Plaintiffs,)
v.) Civil Action No. 85-3906
JAMES C. SANDERS, ET AL.,)
Defendants.)

ORDER

For reasons stated in a Memorandum filed herewith, Plaintiffs' Motion for Summary Judgment is granted; the portion of 13 C.F.R. § 121.2 (1986) promulgated in 50 Fed. Reg. 46,418 (1985), and establishing the small-business size standard for the dredging industry, is declared invalid as arbitrary and contrary to law; the administrative record is remanded to the Small Business Administration for further consideration; and Defendants' Cross-Motion for Summary Judgment is denied.

SO ORDERED.

UNITED STATES DISTRICT JUDGE

November 3, 1986.

Attachment II

Table 4

REGIONS IN WHICH THE SIZE DISTRIBUTION OF FIRMS SUGGESTS A LOWER SIZE STANDARD THAN $9.5 MILLION

(Public information derived from Corps of Engineers files)

INLAND - VICKSBURG, MEMPHIS, ROCK ISLAND, ST. PAUL, TULSA, ST LOUIS, PITTSBURGH, LOUISVILLE AND LITTLE ROCK DISTRICTS

RANK	FIRM	STATUS SIZE	TOTAL DOLLARS AWARDED IN REGION (1980 - 1983)	SHARE OF TOTAL	CUMULATIVE SHARE OF TOTAL
1.	S. J. Cohen Company	Small	18,924,331	15.3	15.3
2.	C. F. Bean Corp.	Large	13,714,385	11.1	26.4
3.	Williams-McWilliams Co.	Large	11,499,606	9.3	35.7
4.	Folk Construction Co., Inc.	Small	10,953,154	8.9	44.6
5.	Cotton Belt	Small	10,561,448	8.5	53.1
6.	Luhr Brothers, Inc.	Large	9,776,034	7.9	61.0
7.	Potashnik & Aetna Surety	Large	7,979,000	6.4	67.4
8.	T.L. James & Company, Inc.	Large	6,600,878	5.3	72.7
9.	Arkansas Valley Dredging Co.	Small	5,162,841	4.2	76.9
10.	MGL Construction, Co., Inc.	Small	4,987,800	4.0	80.9
11.	All Others	-----	23,587,732	19.1	100.0
	TOTAL	-----	123,747,209	----	-----

GREAT LAKES - BUFFALO, CHICAGO, AND DETROIT DISTRICTS

RANK	FIRM	SIZE STATUS	TOTAL DOLLARS AWARDED IN REGION (1980 - 1983)	SHARE OF TOTAL	CUMULATIVE SHARE OF TOTAL
1.	North American Trailing Co.	Large	25,318,600	46.9	46.9
2.	Great Lakes Dredge & Dock Co.	Large	7,851,750	14.6	61.5
3.	Leudtke Engineering Co.	Small	7,746,250	14.4	75.9
4.	Durocher Dock & Dredge Co.	Small	1,745,580	3.2	79.1
5.	Dunbar & Sullivan Dredging Co.	Small	1,454,550	2.7	81.8
6.	Roen Salvage Co.	Small	1,316,966	2.4	84.2
7.	Zenith Dredge Co.	Small	1,218,385	2.3	86.5
8.	J.F. Brennan	Small	1,125,000	2.1	88.6
9.	Edward E. Gillen Co.	Small	941,000	1.7	90.3
10.	A-Bird Construction	Small	864,540	1.6	91.9
11.	All Others	-----	4,351,753	8.1	100.0
	TOTAL	-----	53,934,374	----	-----

Table 4

OTHERS REGIONS (Public information derived from Corps of Engineers files)

E. SOUTHEAST - NORFOLK, WILMINGTON, CHARLESTON, SAVANNAH AND JACKSONVILLE DISTRICTS

RANK		STATUS	TOTAL DOLLARS AWARDED IN REGION (1980 - 1983)	SHARE OF TOTAL	CUMULATIVE SHARE OF TOTAL
1.	Great Lakes Dredge & Dock Co.	Large	55,149,330	15.7	15.7
2.	North American Trailing Co.	Large	45,890,048	12.9	28.6
3.	American Dredging Co.	Large	38,716,717	10.9	39.5
4.	Atkinson Dredging Co.	Small	25,788,907	7.2	46.8
5.	Parkhill-Goodloe Co.	S/L	25,223, 033	7.1	53.8
6.	Bultama	Large	18,920,170	5.3	59.1
7.	Henry Dubois	Large	17,142,410	4.8	63.9
8.	J. A. Laporte, Inc.	Small	15,951,070	4.5	68.4
9.	Bohemia, Inc.	Large	15,199,000	4.3	72.7
10.	Norfolk Dredging Co.	Large	15,751,730	4.4	77.1
11.	All Others	-----	67,711,475	22.9	100.0
	TOTAL	-----	356,056,008	----	----

Attachment III

The chart below is based on complete Corps of Engineers FY 1982 and 1983 contract award data collected for the General Accounting Office.

DREDGING CONTRACTS IN SOUTHEAST REGION

Region	FY	Total # All Contracts	Total $ All Contracts	Total # Sm. Bus. Set-A. Contracts	Total $ Sm. Bus. Set-A. Contracts	Set Aside % of Total $
South East	1982	44	$71,194,992	31	$23,479,150	33%
	1983	38	48,768,872	28	29,114,840	59.7%

Firm Name		Contracts	Set Aside	$ Amount	Set Aside %
Parkhill-Goodloe	'82	7	7	$ 7,724,983	33%
	'83	-	-	-	-
Atkinson	'82	7	7	3,880,224	20%
	'83	7	7	6,241,181	22%
Cottrell	'82	5	5	2,990,727	13%
	'83	4	4	1,755,901	6%
Merritt	'82	3	3	2,816,907	12%
	'83	4	4	2,256,558	8%
J.A. LaPorte	'82	4	3	1,936,400	8%
	'83	2	2	5,749,615	20%
Southern	'82	2	2	1,570,936	7%
	'83	7	7	10,648,046*/	37%
Totals	'82			20,920,177	93%
	'83			20,410,120	93%

1982	Set Asides were 33% of all Corps contracts in SE
1982	Top 6 firms won 93% of all Set Aside contracts. (Top 4 firms won 78%)
1983	Set Asides were 60% of all Corp contracts in SE
1983	Top 5 firms won 93% of all Set Aside contracts (Top 4 firms won 87%)

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*/ Almost $1.1 million over the $9.5 million size standard.

Senator DIXON. Thank you.

Essentially, a good deal of what you said expresses your views on the 30 percent rule, which you essentially support.

Is that right?

Mr. FLETCHER. In essence. But I said I think it is a little crude. I would rather see it as a goal.

Senator DIXON. Well, at least you prefer that over the existing law?

Mr. FLETCHER. Yes.

I think the existing law creates basically a market, a closed market. The mid-sized companies can sit there and dominate the area, and we cannot get in it.

Senator DIXON. And at least in your own experience in the industry in which you compete, you like the idea of some manner of doing it by SIC classification or something of that kind, as distinguished from the totality of the entire award system.

Is that right?

Mr. FLETCHER. I think that is the way it should be. I would hate to see it where the corps or someone would be taking the burden, maybe the set-aside, that's necessary for DOD and increasing it beyond, say, the 30 percent. I don't see the point.

Senator DIXON. Thank you.

Mr. Monk.

STATEMENT OF LEON B. MONK, PRESIDENT, SOUTH ATLANTIC DREDGING CO., INC., CHARLESTON, SC, REPRESENTING THE AMERICAN ASSOCIATION OF SMALL DREDGING AND MARINE CONSTRUCTION COMPANIES, ACCOMPANIED BY KARL E. LUEDTKE, PRESIDENT, LUEDTKE ENGINEERING CO., FRANKFORT, MI

Mr. MONK. Thank you, Mr. Chairman.

My name is Leon B. Monk. I am president of South Atlantic Dredging Co. in Charleston, SC, and chairman of the American Association of Small Dredging and Marine Construction Companies.

Appearing with me is Karl Luedtke, president of Luedtke Engineering Co. in Frankfort, MI, and president of our association.

Senator DIXON. Mr. Luedtke, we are delighted to have you here.

Mr. LEUDTKE. Thank you, Mr. Chairman.

Mr. MONK. The Federal Government purchases about $200 billion worth of goods and services annually. Small business accounts for less than 17 percent of this total, despite the fact that it is responsible for 44 percent of the GNP and 62 percent of all new jobs.

Given these statistics, one would expect that the Congress and the administration would be seeking ways to correct this imbalance.

Regrettably, quite the opposite is occurring, due in large measure to a sustained full court press by big business predators, working in conjunction with their well financed trade associations and high powered lobbyists.

The dredging industry is a case in point.

On May 6, 1983, the SBA published a proposed rule to raise virtually all of the size standards to a level consistent with the effects of inflation since the 1975 adjustment.

For all 10 of the heavy construction groups—except dredging—it proposed an 81 percent increase.

A great deal of controversy surrounded the SBA's dredging recommendation. This resulted in the appointment of a special task force by the SBA Administrator to analyze the dredging industry for the purpose of developing information which would guide the SBA in determining a proper size standard.

On June 4, 1984, 11 months after its creation, the task force published its findings. It concluded its report with a recommendation to raise the size standard to $13.5 million.

The small dredging industry's long, hard fought, 2½ year struggle for equity was finally rewarded when, on December 9, 1985, the $13.5 million size standard become effective.

Big dredging interests and their Washington agents had apparently anticipated an unfavorable outcome of this long, deliberative process because, on the same day that the size standard became effective, they filed a suit in the U.S. District Court to invalidate the regulation.

The court found a technical deficiency in the SBA task force study, and vacated and remanded the rule to the SBA for further consideration. This deficiency has since been addressed by the Corps of Engineers in a letter to the SBA and by the SBA Administrator, James Abdnor, in his report to the Congress.

In light of the report to Congress by Administrator Abdnor, the way is now clear for the restoration of the $13.5 million size standard.

The plight of our industry demonstrates the lengths to which large business interests will go to freeze out the small supplier from the Federal procurement market. A further demonstration of its influence and zeal is contained in P.L. 99-661.

In February 1985, then Congressman and then Small Business Committee Chairman, Parren J. Mitchell, introduced H.R. 1178. Although the stated intent of the bill was to provide equity in the establishment of small business standards, it contained a number of provisions which augured against small business.

On February 25, 1986, the full Small Business Committee rejected the bill on a bipartisan vote.

Shortly after rejection of H.R. 1178, Congressman Mitchell, in concert with Congressman Les Aspin, developed an amendment to the Defense authorization bill. The amendment was similar to, though somewhat more stringent, than H.R. 1178.

It is a matter of serious concern to us, as small businessmen, that legislation which will directly impact on so many small businesses could be enacted without the benefit of a hearing by either the Senate or the House Small Business Committees.

We are specifically concerned that the authority of the Senate and House Small Business Committees was usurped by the Armed Services Committee.

The former Chairman of the House Small Business Committee thwarted the will of his Committee Members, as expressed in their rejection of H.R. 1178.

The Armed Services Committee failed to hold hearings on the amendment.

The Senate Small Business Committee was denied conferee status.

Even a cursory examination of P.L. 99-661 reveals its big business bias.

Let me cite three examples.

Whenever small business is "over-represented" in an industry category—for example, gets more than 30 percent through set-asides, the size standard must be lowered to a level which will reduce the number of contracts which may be set aside to no more than 30 percent.

Yet nowhere is there a comparable requirement to raise the size standard to a level which will enable small businesses to gain a 30-percent share when it is found to be under-represented in a given market.

The market segmentation section of the legislation sets the stage for large companies to petition the SBA to constrict the area of certain markets to a size which they have predetermined will assure the triggering of the 30 percent rule, and the reduction of the size standard in the targeted area.

Before passage of P.L. 99-661, the regulation concerning set-asides required a reasonable price. The stricter requirement of the amendments to meet a fair market price is going to have a chilling effect on procurement officials, who may feel compelled to assure themselves that they are complying with the legislation intent by seeking bids on an unrestricted basis.

This makes a mockery of the Small Business Set-Aside Program.

In our industry, contracts which have traditionally been set aside are already being advertised for unrestricted bidding, even though the legislation is not yet effective.

Mr. Chairman, I am delighted to note that your Subcommittee is cognizant of the damage inherent in this provision of P.L. 99-661, and is taking corrective action through the introduction of S. 1559.

As a consequence of the temporary reduction of the size standard from $13.5 million to $9.5 million, resulting from the U.S. District Court ruling, three dredgers which operate on the Great Lakes were eliminated from the small business ranks. These are Dunbar and Sullivan Dredging Co., Edward E. Gillen Co., and Luedtke Engineering Co.

Since that date, they have been forced to bid against the giant of the industry on an unrestricted basis.

Not one of these companies has been a successful bidder on a single dredging project. Unless they regain the $13.5 million size standard, they may soon be forced out of the dredging business.

Should this occur, it is not illogical to assume that the cost of dredging on the Great Lakes will rise sharply.

Small businesses receive a disproportionately small share of Federal procurements in comparison with their importance to the economy. Unless something is done to right the wrongs of P.L. 99-661, industries singled out in the legislation, and small companies in other industries not yet blanketed by the legislation might soon be relegated to the Federal procurement ash heap.

It is my hope that this subcommittee will develop legislation to safeguard opportunities for small businesses to sell goods and services to the Federal Government. A good place to start would be to overturn the 1986 amendments.

Thank you.

[The prepared statement of Mr. Monk follows:]

Testimony of

Leon B. Monk

President
South Atlantic Dredging Co., Inc.
Chairman
American Association of Small Dredging
and Marine Construction Companies

and

Karl E. Luedtke

President
Luedtke Engineering Company
President
American Association of Small Dredging
and Marine Construction Companies

before the

United States Senate Small Business Committee
Subcommittee on Government Contracting and Paperwork Reduction

September 21, 1987

Mr. Chairman and members of the Committee, I appreciate this opportunity to testify on Section 921 of Title IV of the Department of Defense Authorization Act for 1987.

My name is Leon B. Monk. I am President of South Atlantic Dredging Company in Charleston, South Carolina, and Chairman of the American Association of Small Dredging and Marine Construction Companies. Appearing with me is Karl E. Luedtke, President of Luedtke Engineering Company in Frankfort, Michigan, and President of our association.

The American Association of Small Dredging and Marine Construction Companies was established to promote the utilization of small dredging and marine construction companies in the development and maintenance of our nation's waterways. Although we are a relatively young organization, our membership already embraces every region of the country, other than the west coast. Our rapid growth is attributable to the concern of small dredgers that they are in danger of being overwhelmed by large dredging interests who are intent on nullifying our participation in the Federal procurement process.

The Federal government purchases about $200 billion of goods and services annually. Small business accounts for less than 17% of this total, despite the fact it is responsible for 44% of the GNP and 62% of all new jobs.

Given these statistics, one would expect that the Congress and the Administration would be seeking ways to correct this imbalance. Regrettably, quite the opposite is occurring, due, in large measure, to a sustained, full-court press by big business predators, working in conjunction with their well financed trade associations and high-powered lobbyists. The dredging industry is a case in point.

In 1975, the Small Business Administration amended its size standards. The dredging industry was raised to $9.5 million, with little or no opposition. Four years later, a petition was filed on behalf of the "Dredging Industry Size Standard Committee" (DISSC). It claimed that the prevailing size standard was unfair to small dredgers and should, therefore, be lowered. Since it is my understanding that most, if not all, of its funding comes from large companies, I find the DISSC's "concern" for small dredgers to be a curious phenomenon.

On May 6, 1983,the SBA published a proposed rule to raise virtually all of the size standards to a level consistent with the effects of inflation since the 1975 adjustment. For all ten of the heavy construction groups---except dredging---it proposed an 81% increase. Apparently heeding the advice of the DISSC petitioners, the SBA proposed to maintain the dredging industry size standard at its 1975 level of $9.5 million.

A great deal of controversy surrounded the SBA's dredging recommendation. This resulted in the appointment of a special task force by the SBA Adminstrator to analyse the dredging industry for the purpose of developing information which would guide the SBA in determining a proper size standard.

In discharging its responsibilities, the task force held in-depth discussions with representatives from the dredging industry, the Navy Department, and the Army Corps of Engineers. It solicited and analyzed responses to a detailed questionnaire which it had mailed to every known dredging company.

On June 4, 1984, eleven months after its creation, the task force published its findings. It concluded its report with a recommendation to raise the size standard to $13.5 million. It is worth noting that the report was characterized by the Corps of Engineers as "...the most complete and comprehensive analysis ever conducted to support a dredging size standard...."

The task force report was reviewed and approved by the SBA's Size Policy Board. Thereupon, the SBA proposed a final rule establishing a dredging size standard of $13.5 million. This proposal was published in the Federal Register on December 4, 1984.

Following the expiration of the comment period, the entire matter was once again reviewed by the SBA's Size Policy Board. The Board reaffirmed its earlier findings. The small dredging industry's long, hard fought, two-and-one-half-year struggle for equity was finally rewarded when, on December 9, 1985, the $13.5 million size standard became effective.

Big dredging interests and their Washington agents had apparently anticipated an unfavorable outcome of this long, deliberative process because, on the same day that the size standard became effective, they filed a suit in the U.S. District Court to invalidate the regulation. The Court found a technical deficiency in the SBA task force study, and vacated and remanded the rule to the SBA for further consideration. This deficiency has since been addressed by the Corps of Engineers in a letter to the SBA, and by the SBA Administrator, James Abdnor, in his report to the Congress. In light of the report to Congress by Administrator Abdnor, the way is now clear for the restoration of the $13.5 million size standard.

The plight of our industry demonstrates the lengths to which large business interests will go to freeze out the small supplier from the Federal procurement market. A further demonstration of its influence and zeal is contained in Public Law 99-661.

In February, 1985, former Congressman and former Small Business Committee Chairman, Parren J. Mitchell, introduced HR 1178. Although the stated intent of the bill was to "...provide equity in the establishment of small business standards...", it contained a number of provisions which augured against small business.

Hearings on the bill were held by the Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems on July 30-31, 1985. Testimony of private sector witnesses was restricted to only those who favored the bill, causing some wonderment among those of us who opposed it.

On February 25, 1986, following several delays, the bill was moved up to the full Small Business Committee for mark-up. A spirited debate ensued, following which the bill was rejected on a bipartisan vote.

Shortly after rejection of HR 1178, Congressman Mitchell, in concert with Congressman Les Aspin, developed an amendment to the Defense Authorization Bill (HR 4428). The Amendment was similar to, though somewhat more stringent than HR 1178.

HR 4428 was favorably voted out by the Armed Services Committee. When it reached the floor of the House on August 5, 1986, it ran into vigorous opposition, led by Congressman Jim Cooper of Tennessee. During the floor debate, Congressman Aspin moved to restrict HR 4428 to four industries: Construction (except dredging); Architectural and engineering services; Ship building and ship repair; and, Refuse systems and related services. His motion was supported by Congressman Mitchell. As thus modified, the Amendment carried and went to conference. It later emerged as a portion of the Defense Authorization Act, with the dredging industry reinserted as a targeted industry.

It is a matter of serious concern to us, as small businessmen, that legislation which will directly impact on so many small businesses could be enacted without the benefit of a hearing by either the Senate or House Small Business Committees. We are specifically concerned that:

.The authority of the Senate and House Small Business Committees was usurped by the Armed Services Committee.

.The former Chairman of the House Small Business Committee thwarted the will of his Committee members, as expressed ir their rejection of HR 1178.

.The Armed Services Committee failed to hold hearings on the Amendment.

.The Senate Small Business Committee was denied Conferee status.

Even a cursory examination of PL99-661 reveals its big-business bias. Let me cite three examples:

1. Whenever small business is "overrepresented" in an industry category (i.e. gets more than 30% through set-asides), the size standard must be lowered to a level which will reduce the number of contracts which may be set-aside to no more than 30%. Yet, nowhere is there a comparable requirement to raise the size standard to a level which will enable small businesses to gain a 30% share, when it is found to be "underrepresented" in a given market.

2. The market segmentation section of the legislation sets the stage for large companies to petition the SBA to constrict the area of certain markets to a size which they have predetermined will assure the triggering of the "30% rule", and the reduction of the size standard in the targeted area.

Acting on the (erroneous) assumption that this provision covers dredging, our big business counterparts are already zeroing in on an area of the country where small dredging activity still flourishes. The spokespersons for their DISSC have urged that a small piece of geography----a few, carefully selected states in the Southeast in which set-aside activity has been predetermined to meet the "30% rule"----be designated as a geographic market, even though such a recommendation disregards the obvious fact that any dredging company, located anywhere along the East Coast, has total mobility to perform dredging anywhere from Maine to Florida. But since the "30% rule" would not serve their objectives when applied to such a large area, the DISSC spokespersons have opted to recommend that a smaller, completely artificial boundary be designated by the SBA as a marketing area.

3. Before passage of PL99-661, the regulation governing set-asides required a "reasonable price". The stricter requirement of the amendments to meet a "fair market price" is going to have a chilling effect on procurement officials, who may feel compelled to assure themselves that they are complying with the legislation's intent by seeking bids on an unrestricted basis. This makes a mockery of the small business set-aside program. In our industry, contracts which have traditionally been set aside, are already being advertised for unrestricted bidding, even though the legislation is not yet effective.

Mr. Chairman, I am delighted to note that your Committee is cognizant of the damage inherent in this provision of PL99-661 and is taking corrective action through the introduction of S.1559

The dredging industry is sharply divided into large and small companies. Millions and millions of dollars of revenues separate us from the large dredgers, which are, for the most part, corporate divisions of huge conglomerates. Lowering our size standard forces us to compete on unequal terms in which the capital resources of big business can be brought to bear to "low ball" the market until we are squeezed out. My colleague, Karl Luedtke, can attest to the fact that this is already occurring on the Great Lakes.

As a consequence of the temporary reduction of the size standard from $13.5 million to $9.5 million, resulting from the U. S. District Court ruling, three dredgers which operate on the Great Lakes were eliminated from the small business ranks. These are: Dunbar & Sullivan Dredging Company, Edward E. Gillen Company, and Luedtke Engineering Company. Since that date, they have been forced to bid against the giant of the industry on an unrestricted basis. Not one of these companies has been a successful bidder on a single dredging project. Unless they regain the $13.5 million size standard, they may soon be forced out of the dredging business. Should this occur, it is not illogical to assume that the cost of dredging on the Great Lakes will rise sharply.

I am quite certain that the big business pressures we small dredgers face is not unique, particularly with respect to those industries caught up in the web of PL99-661.

As stated earlier in my testimony, small businesses receive a disproportionately small share of Federal procurements in comparison with their importance to the economy. Unless something is done to right the wrongs of PL99-661, industries singled out in the legislation, and small companies in other industries not yet blanketed by the legislation, might soon be relegated to the Federal procurement ash heap.

It is my hope that this Committee will develop legislation to safeguard opportunities for small businesses to sell goods and services to the Federal government. A good place to start would be to overturn the 1986 amendments.

Thank you for allowing me to testify. Mr. Luedtke and I would be happy to answer your questions.

Senator DIXON. Thank you.

Several things that you said in your testimony are interesting to me, Mr. Monk. The first is that I am not sure that the Congress generally knows that not only was the law changed without any input on the part of the Senate at all, either in hearings, for that matter not only by the Small Business Committee, but by the Armed Services Committee as well, but your testimony is that the Small Business Committee of the House had rejected legislation similar to what was finally adopted in the DOD authorization bill in Section 921?

Mr. MONK. Yes, sir.

Senator DIXON. Do you remember what the roll call vote was on that?

Mr. MONK. No, sir. I don't have that information, but I will be glad to check on that.

Senator DIXON. Well, I hope that our staff will develop that.

I am told that it was on a 26 to 22 vote for similar provisions.

Would you happen to know whether the 30 percent rule was part of that bill that was rejected?

[No response.]

Senator DIXON. Staff can look at that.

[Pause.]

Senator DIXON. It was not.

Another thing, just as a matter of curiosity.

Again, you understand that we are not experts on all things and we learn from folks like you.

Is size that much of a consideration in competitive bidding for dredging? I get the impression from what you are saying that the big guys can just knock out the little guys all the time, or the smaller ones. Is that factual?

Mr. MONK. Yes, sir. I think that is a definite fact.

Senator DIXON. Well, then, I guess my question would be why would that be so true in that particular industry? I would imagine there is some advantage competitively to bigness in almost everything.

Mr. MONK. Well, certainly there are economies of size and capital investment.

Senator DIXON. I see.

Mr. Fletcher, did you have any comment?

Mr. FLETCHER. I would just like to add a little bit to that. Specifically, when Mr. Monk was talking about the companies of the Great Lakes area that were kicked out of the small business set-aside work, they were not successful bidders on any dredging projects. During that same period, where there were 12 unrestricted bids, two of those were awarded to small businesses, outside of the Set-Aside Program.

So there was a situation where they were competing effectively with large companies.

Senator DIXON. I am going to have staff look into this. You obviously represent different points of view within your industry. Now that is perfectly all right. We see that in the Congress all the time. I will look into that carefully.

I guess your industry, more than most, would be regional in character, would it not?

Now, I don't know. But a Florida dredger is not going to do any dredging in the Great Lakes, or vice versa, I presume?

Mr. FLETCHER. That is a function of size?

Senator DIXON. Of what, please?

Mr. FLETCHER. Of size.

Senator DIXON. Do you mean that the great, big ones might be everywhere?

Mr. FLETCHER. They can move everywhere. But when you get down to where the small businesses are, it is very regional.

Senator DIXON. Mr. Luedtke, you are here. Now you did not testify, but your name was mentioned as being a troubled business as a consequence of the changes that are being made anticipatory of the section 921 adoption last year.

What is your statement about that?

Mr. LEUDTKE. Of course, there are abrupt changes—first we are a small business, and then we are not. There was little advance notice. Three companies, as we said, were eliminated from the market.

Now, of those three companies, the amount of dredging business that we had done in previous years, in the previous 3 years, was such that our company averaged maybe $3 million in the dredging business. One of our other competitors averaged $4 million. The other company averaged less than $1 million. We were eliminated from the dredging market primarily because we were also in the construction business.

Senator DIXON. What is the size of the "big boys" in your industry? Mr. Fletcher says he is at $1.5 million and you are at $3 million.

Mr. FLETCHER. Excuse me. He was $3 million in the dredging. But in general construction he is over $10 million. Then you see a problem where a large construction company has a dredging arm. That is not fair, to compete with me, which is a complete dredging company.

Mr. LEUDTKE. The large company has done at least $70 million per year in dredging business for the Corps of Engineers over the last number of years. And, in fact, in the last 3 years, that company has taken over 50 percent of the market in the Great Lakes area.

One company has 50 percent of the market, and probably 30 percent of the market nationally.

Senator DIXON. Is all of your work done with the Corps of Engineers, that is, you who are here? I guess that it is.

Mr. MONK. The bulk of it is, yes.

Mr. FLETCHER. But that is not true with us because we have such a problem of getting into the set-aside work. The bulk of ours is private. To break into set-aside work against a $10 million company is awfully tough. It is very capital-intensive, with a lot of equipment necessary. When a company is around the $10 million range, they have essentially the same type of dredge that these larger dredging companies have, but they just don't have so many of them.

Senator DIXON. I must say, generically—because the time for closing the hearings is almost upon us—that I do have some concerns, having heard all the testimony this morning, about the totality of how we ought to respond to section 921. There seems to be a lot of opposition to various parts of it. Some like some of the provisions of it.

It occurs to me that we waited so long to get everything from all of the agencies and all of the affected business interests in the country that we are running out of time to find a solution to exactly what we ought to try to do before October first.

Maybe we ought to consider that a little more time is one of the possibilities for coming to our final decision here. In view of the whole track record of this, and, as a Senator, I have to say that we do a lot of things on the floor of the Senate without having held hearings. Maybe that is not good, but we do this, by the amendatory process.

But I really think that the historical background of this section 921 is pretty flawed. To have a committee that was really the jurisdictional committee reject it, and then—were there hearings on the DOD authorization bill in the House on this issue, or did they just kind of work out some language and put it into the bill? Do any of you know, by chance?

[No response.]

Senator DIXON. It really just seems to have been put into the bill. It really does have a kind of flawed track record from the standpoint of public discussion of these changes.

I don't say that a lot of them would not be finally what we would do, frankly, but this bothers me a lot.

So, I think this has been very helpful. All of you have been very helpful.

I apologize for the fact that other subcommittee Members were not here this morning, but, frankly, you probably all know that we are on the DOD authorization bill. We have been on it all last week and will be on it all next week. Everybody has been working night and day on it. It is difficult to gather some people together here on what is essentially a day off for us, that is, today.

I thank you all for coming and for what you have said. Your prepared texts as well as your testimony here has been very useful. I assure you that we will give this some careful thought.

I will be discussing this with the Chairman, Senator Bumpers, and the distinguished Ranking Member, Senator Weicker. We will give some careful thought to how we ought to respond.

I think that we feel that some kind of response is needed to give the Congress an opportunity to make a more careful evaluation of what we ought to be doing here.

Thank you very much.

This Subcommittee hearing is adjourned.

[Whereupon, at 11:45 a.m., the Subcommittee adjourned, to reconvene upon the call of the Chair.]

APPENDIX

STATEMENT OF THE

AMERICAN WATERWAYS SHIPYARD CONFERENCE
(A CONFERENCE OF THE AMERICAN WATERWAYS OPERATORS)

ON

AMENDMENTS TO THE SMALL BUSINESS ACT

presented by

D.F. SMITH
CHAIRMAN, AMERICAN WATERWAYS SHIPYARD CONFERENCE

AND

DIRECTOR OF MARKETING
BENDER SHIPBUILDING AND REPAIR CO., INC.

before the

SUBCOMMITTEE ON GOVERNMENT CONTRACTING AND PAPERWORK REDUCTION
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE

SEPTEMBER 21, 1987

GOOD MORNING. MY NAME IS DELMAR F. SMITH AND I AM DIRECTOR OF MARKETING FOR BENDER SHIPBUILDING AND REPAIR CO., INC., LOCATED IN MOBILE, ALABAMA. I AM HERE TODAY IN MY CAPACITY AS CHAIRMAN OF THE AMERICAN WATERWAYS SHIPYARD CONFERENCE OR AWSC, A CONFERENCE OF THE AMERICAN WATERWAYS OPERATORS, THE NATIONAL ORGANIZATION REPRESENTING THE INTERESTS OF THE INLAND AND COASTAL TUG AND BARGE INDUSTRY. AWSC REPRESENTS THE INTERESTS OF THE SMALL AND MEDIUM SIZED OR SECOND TIER COMMERCIAL SHIPYARDS.

WE APPRECIATE THE OPPORTUNITY TO APPEAR HERE TODAY TO EXPRESS OUR VIEWS ON THE SMALL BUSINESS ADMINISTRATION'S (SBA) REVIEW OF THE SMALL BUSINESS SET-ASIDE PROGRAM AS MANDATED BY P.L. 99-591, AN ACT MAKING CONTINUING APPROPRIATIONS FOR FISCAL YEAR 1987, AND P.L. 99-691, THE NATIONAL DEFENSE AUTHORIZATION ACT FOR FISCAL YEAR 1987. BENDER SHIPBUILDING AND REPAIR CO., INC. DOES QUALIFY AS A SMALL BUSINESS UNDER THE CURRENT REGULATIONS AND CONSISTENTLY COMPETES FOR CONTRACTS IN BOTH SET-ASIDE AND UNRESTRICTED CATEGORIES.

BEFORE OFFERING COMMENT ON SBA'S REVIEW, I WOULD LIKE TO TAKE A MOMENT TO ACQUAINT YOU WITH OUR INDUSTRY. THE SEGMENT OF THE SHIPBUILDING AND REPAIR INDUSTRY REPRESENTED BY AWSC IS COMPRISED OF APPROXIMATELY 250 SMALL TO MEDIUM SIZED COMMERCIAL SHIPYARDS. ABOUT HALF OF THESE SHIPYARDS ARE LOCATED ON THE GULF COAST, 15 PERCENT ON THE INLAND RIVERS, 20 PERCENT ON THE ATLANTIC COAST, 13 PERCENT ON THE PACIFIC COAST, AND 2 PERCENT ON THE GREAT LAKES. THESE SHIPYARDS SERVE THE DOMESTIC WATER TRANSPORTATION, THE

OFFSHORE OIL AND THE U.S. FISHING INDUSTRIES, AND FULFILL THE MILITARY CONTRACTS FOR THE SMALLER VESSELS. THEY PROVIDE DESIGN, NEW CONSTRUCTION AND REPAIR SERVICES. IT IS THESE SAME SHIPYARDS WHICH ARE ACTIVELY INVOLVED IN THE SET-ASIDE PROGRAM ADMINISTERED BY SBA.

SIMILAR TO THE LARGER SHIPYARDS, OUR INDUSTRY IS EXPERIENCING ECONOMIC DIFFICULTIES. WE ARE IN SLIGHTLY BETTER SHAPE THAN IN 1983, BUT WE ARE STILL IN A SEVERE DEPRESSION. SINCE 1982, WE HAVE LOST SEVERAL MAJOR NEW CONSTRUCTION SHIPYARDS: JEFFBOAT, INCORPORATED, JEFFERSONVILLE, IN; ST. LOUIS SHIP, ST. LOUIS, MO; DRAVO MARINE EQUIPMENT COMPANY, PITTSBURGH, PA; AND U.S.S. FABRICATION, AMBRIDGE, PA. OVERALL, SEVENTY-NINE SECOND TIER SHIPYARDS HAVE CLOSED BETWEEN 1982 AND 1986. WE HAVE SEEN NEW CONSTRUCTION ACTIVITY DECLINE BY NINETY-ONE PERCENT BETWEEN 1981 AND 1986. THERE ARE A FEW NEW CONSTRUCTION CONTRACTS, BUT NOTHING COMPARED TO THE LATE SEVENTIES AND EARLY EIGHTIES.

DUE TO THE NATURE OF THE MARKETPLACE, REPAIR ACTIVITY HAS DECLINED IN PROPORTION TO THE OVERALL DECLINE IN SHIPPING AND SHIPBUILDING. MANY YARDS HERETOFORE PRIMARILY DEDICATED TO SHIPBUILDING HAVE HAD TO SHIFT TO SEEK REPAIR WORK. THEREFORE, THERE ARE MORE FACILITIES COMPETING FOR THE SAME AMOUNT OF REPAIR WORK. OVERALL EMPLOYMENT LEVELS FOR OUR INDUSTRY SECTOR HAVE DROPPED FROM A HIGH OF 50,000 IN 1982 TO A LITTLE OVER 10,000 IN 1986, AN EIGHTY PERCENT DECREASE. CLEARLY THE SECOND TIER SHIPYARDS ARE IN SEVERE DISTRESS, HOWEVER, WE ARE WORKING TO OVERCOME THESE PROBLEMS AND

PRESS FORWARD.

THE OVERALL CHANGES MADE TO THE ADMINISTRATION OF THE SET-ASIDE PROGRAM ARE SWEEPING, AND FROM OUR VIEWPOINT, NECESSARY. THE SET-ASIDE PROGRAM IS VALUABLE FOR INDUSTRY IN GENERAL, AND FINE TUNING OF ANY PROGRAM OVER THE YEARS IS A NECESSITY TO KEEP IT'S INTEGRITY INTACT. WE APPLAUD THE EFFORTS TO TIGHTEN PROVISIONS TO ELIMINATE ABUSES OF THE SYSTEM. THE CHANGES SUGGESTED BY THE IMPLEMENTING LEGISLATION, S. 1559, AND RECOMMENDED BY SBA IN THEIR JULY 14TH REPORT WILL HELP MAKE THE PROGRAM MORE EFFECTIVE AND BENEFICIAL TO THE ENTIRE SMALL BUSINESS COMMUNITY. HOWEVER, ONE ELEMENT OF THE MANDATED CHANGES WILL NOT SERVE TO FINE TUNE THE PROGRAM, BUT HAMSTRING IT. I AM REFERRING TO THE REVIEW OF THE SHIPBUILDING AND SHIP REPAIR INDUSTRIES MANDATED BY THE AFOREMENTIONED PUBLIC LAWS TO ASCERTAIN IF CHANGES ARE NECESSARY TO THE ADMINISTRATION OF THE SET-ASIDE PROGRAM FOR THESE TWO INDUSTRY SECTORS.

THIS IS NOT THE FIRST REVIEW, NOR IS THE SUBJECT OF REVISING THE SIZE STANDARD FOR THE INDUSTRY A NEW SUBJECT. WE HAVE BEEN DEBATING THIS ISSUE WITHIN THE INDUSTRY SINCE SBA FIRST ISSUED A NOTICE IN 1981 EXPRESSING THEIR INTENT TO REVIEW AND POSSIBLY REVISE THE SHIPBUILDING AND SHIP REPAIR INDUSTRY SIZE STANDARD. AGAIN IN 1985, SBA REVIEWED THE INDUSTRY'S SIZE BY REQUEST TO DETERMINE IF SHIPBUILDING AND SHIP REPAIR ACTIVITIES SHOULD BE ACCORDED SEPARATE SIZE STANDARDS OF 1,000 AND 500 EMPLOYEES RESPECTIVELY. IN CONCLUSION, SBA DETERMINED THAT NO SPLIT IN THE CURRENT SIZE STANDARD WAS

NECESSARY. THE CURRENT SIZE STANDARD SET AT 1,000 EMPLOYEES WAS SEEN TO ADEQUATELY REFLECT BOTH SHIPBUILDING AND REPAIR ACTIVITIES SINCE MOST, IF NOT ALL, MEDIUM TO SMALL SIZED COMMERCIAL SHIPYARDS COMPETE FOR BOTH TYPES OF WORK.

THIS IS AN ISSUE STEEPED IN CONTROVERSY. EVEN WITHIN OUR OWN MEMBERSHIP, WE HAVE A WIDE VARIETY OF OPINION. EVEN THOUGH, ALL AWSC MEMBERS ARE CONSIDERED SMALL SHIPYARDS BY VIRTUE OF EMPLOYMENT SIZE AND WORK PERFORMED, ALL ARE NOT CONSIDERED SMALL BY VIRUTE OF AFFILIATION.

WE MAY NOT BE ABLE TO AGREE ON A SET SIZE STANDARD WHICH ALL FEEL IS APPLICABLE AND REFLECTIVE OF THE INDUSTRY, BUT WE DO AGREE ON ONE POINT. THE AMERICAN WATERWAYS SHIPYARD CONFERENCE DOES NOT SUPPORT THE SEGMENTATION OF THE SHIPBUILDING AND SHIP REPAIR SIZE STANDARD AS OUTLINED IN THE MARCH 17, 1987 FEDERAL REGISTER NOTICE. IT REPRESENTS A SERIOUS SHIFT IN SBA'S POLICY. THE PROPOSED GEOGRAPHIC PROGRAM SHIFTS THE FOCUS OF THE SMALL BUSINESS SET-ASIDE PROGRAM FROM CONSIDERATION OF INDIVIDUAL COMPANIES TO ONE OF REGIONAL PERSPECTIVE. FAR TOO MUCH POLITICAL ATTENTION HAS BEEN CENTERED ON THE ADMINISTRATION OF THE SET-ASIDE PROGRAM FOR OUR INDUSTRY. THE GEOGRAPHICAL SEGMENTATION APPROACH AS DISCUSSED BY FORMER CHAIRMAN OF THE HOUSE SMALL BUSINESS COMMITTEE PARREN MITCHELL IN HIS EXTENSION OF REMARKS ON THE IMPACT OF THE NATIONAL DEFENSE AUTHORIZATION ACT ON SMALL BUSINESS, IS ANOTHER EXAMPLE OF POLITICAL INTERVENTION INTO AN IMPORTANT GOVERNMENT ACTIVITY, NAMELY THE SMALL BUSINESS SET-ASIDE PROGRAM

FOR THE SMALL AND MEDIUM SIZED COMMERCIAL SHIPYARDS. A GEOGRAPHICALLY SEGMENTED SIZE STANDARD FOR THE SHIPBUILDING AND, AND MORE SPECIFICALLY, THE SHIP REPAIR INDUSTRY, SET BY GEOGRAPHICAL REGIONS AS OUTLINED BY SBA IN THEIR MARCH 17TH FEDERAL REGISTER NOTICE AND IN THE COMPLETED STUDY, IS ARBITRARY, INCOMPLETE AND INCONSISTENT WITH THE SPIRIT OF THE SMALL BUSINESS ADMINISTRATION.

INCLUDED IN THE LANGUAGE OF BOTH P.L. 99-591 AND P.L. 99-691 WAS A SECTION REQUIRING SBA TO STUDY THE SHIPBUILDING AND SHIP REPAIR INDUSTRIES TO DETERMINE IF ITS SIZE STANDARD SHOULD BE ONE, LOWERED IF THE SHARE OF FEDERAL CONTRACTS EXCEEDED THIRTY PERCENT; AND TWO, IF THE SIZE STANDARD FOR THE SHIP REPAIR INDUSTRY SHOULD BE GEOGRAPHICALLY SEGMENTED. IN ACCORDANCE WITH THESE PROVISIONS, SBA HAS RELEASED ITS REPORT ADDRESSING THESE ISSUES. I WOULD LIKE TO DISCUSS THE SHORTFALLS OF THE PROPOSED CHANGES FOR OUR INDUSTRY AS CONTAINED IN THE MARCH 17TH FEDERAL REGISTER NOTICE AND AS DISCUSSED IN SBA'S REPORT ENTITLED "VOLUME II, ADVISABILITY AND FEASIBILITY OF IMPLEMENTING SECTION 921(f) OF PUBLIC LAW 99-691."

FROM THE RESULTS OF SBA'S RESEARCH, IT HAS BEEN DETERMINED THAT THE SIZE STANDARD FOR THE SHIPBUILDING AND REPAIR INDUSTRY DOES NOT NEED TO BE LOWERED. CONTRACTS AWARDED DO NOT EXCEED THIRTY PERCENT OF THE MARKETPLACE. THEY ONLY ACCOUNT FOR EIGHT PERCENT. IT IS STILL UNCLEAR THAT IF THE SHIP REPAIR SIZE STANDARD IS SEGMENTED, WILL IT ALSO BE LOWERED? IF THE SIZE STANDARD IS TO BE LOWERED, WE QUESTION THE APPLICABILITY OF THE

METHOD CHOSEN BY SBA TO REVISE THE SIZE STANDARDS.

THE RATIONALE BEHIND THE COUNTDOWN METHOD IS TO ELIMINATE THE LARGER SMALL FIRMS FROM ELIGIBILITY, THEREBY OPENING UP PREVIOUSLY RESERVED SET-ASIDE CONTRACTS FOR UNRESTRICTED BIDDING. IT IS DIFFICULT TO UNDERSTAND THE METHOD USED TO DETERMINE THE NEW SIZE STANDARD FROM SBA'S DISCUSSION ON THE APPLICATION OF THE COUNTDOWN METHOD CONTAINED IN THE JULY 14TH REPORT.

A FEW OTHER PROBLEMS EXIST. ONE, THE EXAMPLE LISTED IS BASED ON REVENUE AND NOT EMPLOYEES; AND, TWO, THE COUNTDOWN METHOD ASSUMES THAT THE LARGER SMALL FIRMS ARE THE COMPANIES WINNING THE BULK OF THE FEDERAL CONTRACTS. THIS MAY NOT BE THE CASE IN OUR INDUSTRY. IT IS OUR BELIEF THAT THE SMALL FIRMS WINNING THE CONTRACTS ARE TRULY SMALL FIRMS AND THEIR SIZE IS REFLECTIVE OF THE NATURE OF THE WORK TO BE ACCOMPLISHED.

ON THE TOPIC OF GEOGRAPHICAL SEGMENTATION, SBA LISTS THREE FACTORS USED TO DETERMINE IF SUCH AN ACTION IS WARRANTED: ONE, IF THE GOVERNMENT TYPICALLY DESIGNATES WHERE THE CONTRACT IS TO BE PERFORMED; TWO, IF GOVERNMENT PURCHASES COMPRISE THE MAJOR PORTION OF THE DOMESTIC MARKET; AND THREE, IF DUE TO THE FIXED NATURE OF THE FACILITIES IT IS UNREASONABLE TO EXPECT COMPETITION FROM OUTSIDE THE IMMEDIATE AREA. IF THE INDUSTRY IS CHARACTERIZED BY THESE FACTORS, THEN THE SIZE STANDARD COULD BE SEGMENTED. THE GEOGRAPHICAL BREAKDOWN PROPOSED BY SBA IN ITS MARCH 17TH FEDERAL REGISTER NOTICE IS AS FOLLOWS:

(1) NUCLEAR SHIP REPAIR AND SHIPBUILDING

(2) SHIPBUILDING (NONNUCLEAR)

(3) NONNUCLEAR SHIP REPAIR AT:

   (A) PUGET SOUND/PORTLAND
   (B) SAN FRANCISCO
   (C) LOS ANGELES/LONG BEACH
   (D) SAN DIEGO
   (E) NEW ENGLAND
   (F) NEW YORK/PHILADELPHIA/NEW JERSEY
   (G) NORFOLK/BALTIMORE
   (H) CHARLESTON
   (I) JACKSONVILLE, FLORIDA
   (J) GULF COAST

THIS LIST, WHICH IS BASED ON THE CURRENT NAVY HOMEPORT PROGRAM, IS ANOTHER DIVISIVE ISSUE WITHIN THE INDUSTRY. THROUGHOUT THE LIFE OF THIS CURRENT REVIEW IT HAS BEEN ASSUMED THAT THE DEPARTMENT OF NAVY IS THE ONLY SOURCE OF GOVERNMENT SHIP REPAIR WORK FOR THE INDUSTRY. WHILE THIS MAY BE TRUE FOR THE LARGER SHIPYARDS, IT IS NOT TRUE FOR THE SMALLER SHIPYARDS. WHILE THE DEPARTMENT OF NAVY DOES PROVIDE THE MAJORITY OF THE GOVERNMENT WORK, IT IS NOT THE ONLY GOVERNMENT AGENCY WHICH LETS CONTRACTS FOR SHIPBUILDING AND SHIP REPAIR ACTIVITIES. THESE SAME SMALL TO MEDIUM SIZED SHIPYARDS COMPETE FOR GOVERNMENT CONTRACTS NOT ONLY FROM THE U.S. NAVY, BUT THE U.S. ARMY, ARMY CORPS OF ENGINEERS, UNITED STATES

COAST GUARD, THE MARITIME ADMINISTRATION, U.S. AIR FORCE, AND THE DEPARTMENT OF COMMERCE IT IS NOT ONLY THE NAVY WHICH PROVIDES WORK FOR THE INDUSTRY, LARGE AND SMALL SHIPYARDS ALIKE.

IN RESPONSE TO THE CRITERIA LISTED EARLIER CONCERNING GOVERNMENT DESIGNATION OF LOCATION OF WORK TO BE PERFORMED, ONLY THE U.S. NAVY, HAS A FORMAL PROGRAM, I.E., HOMEPORTING. OTHER GOVERNMENT AGENCIES IMPOSE LIMITATIONS WITHIN THE CONTRACT IN THE FORM OF ADDED COSTS FOR FACTORS OUTSIDE A CERTAIN GEOGRAPHICAL AREA. THIS PRACTICE SERVES TO LIMIT THE WORK TO CERTAIN GEOGRAPHICAL DESIGNATIONS.

IN RESPONSE TO THE SECOND CRITERIA CONCERNING DOMINANCE OF GOVERNMENT CONTRACTS IN THE MARKETPLACE, GOVERNMENT PURCHASES DO NOT COMPRISE THE MAJOR PORTION OF THE DOMESTIC MARKET FOR THE SECOND TIER SHIPBUILDING AND REPAIR INDUSTRY. THE SMALLER SHIPYARDS CONTRIBUTE TO OUR NATION'S ECONOMY BY SERVICING THE VESSELS OF THE VARIOUS DOMESTIC FLEETS. BY LAW, ALL VESSELS IN OUR DOMESTIC TRADES MUST BE BUILT IN U.S. SHIPYARDS. OUR SHIPYARDS BUILD AND REPAIR TUGBOATS, TOWBOATS, HOPPER BARGES, TANK BARGES, DECK BARGES, A WHOLE HOST OF OTHER TYPES OF BARGES USED IN THE OFFSHORE AND COASTWISE TRADES, THE SMALLER PASSENGER VESSELS, A WIDE VARIETY OF OFFSHORE SUPPLY BOATS, FISHING VESSELS, AND FISH PROCESSING VESSELS. ACCORDING TO THE AMERICAN WATERWAYS SHIPYARD CONFERENCE'S 1986 ANNUAL SHIPYARD SURVEY 13,800 POWER DRIVEN VESSELS AND RIVER AND OFFSHORE BARGES WERE REPAIRED IN 1986, COMPARED TO 15,000 VESSELS IN 1985.

WE ALSO BUILD THE SMALLER CRAFT FOR ALL THE ARMED SERVICES, AS WELL AS REPAIR A WIDE VARIETY OF NAVY COMBATTANT AND AUXILIARY VESSELS. THIS IS A TREMENDOUS RANGE OF VESSEL TYPES SERVICED BY OUR INDUSTRY SECTOR. ALSO, MANY OF THE CONTRACTS WON BY THE SMALLER SHIPYARDS FROM THESE AGENCIES ARE NOT UNDER THE SET-ASIDE PROGRAM. WE DO AGREE THAT GOVERNMENT PURCHASES MAY DOMINATE THE MARKETPLACE IN A SPECIFIC GEOGRAPHICAL REGION, BUT AGAIN, THAT MAY BE DUE TO THE FACT THAT THE CURRENT NAVY HOMEPORT PROGRAM AND OTHER CONTRACTING PRACTICES HAVE PROVIDED A GREAT DEAL OF INFLUENCE IN THAT RESPECT.

ALTHOUGH THE SHIPYARD FACILITIES ARE FIXED AS THE THIRD CRITERIA OUTLINES, THE SHIPYARD EMPLOYEES ARE NOT. IT IS NOT UNHEARD OF FOR A SHIPYARD TO UNDERTAKE TOPSIDE REPAIR ON A VESSEL IN AN ENTIRELY DIFFERENT LOCATION. THE TOPIC OF TOPSIDE REPAIR BRINGS UP ANOTHER ISSUE, THAT OF NUCLEAR VERSUS NONNUCLEAR. GRANTED, NONE OF THE SMALLER FACILITIES WOULD LIKELY BE QUALIFIED AS A NUCLEAR FACILITY, HOWEVER, WE ROUTINELY DO WORK ON NUCLEAR AIRCRAFT CARRIERS WHEN THE WORK DOES NOT INVOLVE THE NUCLEAR COMPONENTS.

IT HAS BEEN ALLUDED TO THAT THE FIXED NATURE OF REPAIR FACILITIES ALSO POINTS TO THE NEED TO SEGMENT THE SHIP REPAIR SIZE STANDARD. LET ME ALSO SAY, THAT LAST TIME I CHECKED, A NAVY SHIP, LARGE OR SMALL, STILL HAS THE CAPABILITY TO MOVE AT SEA, AND CONSEQUENTLY COULD MOVE TO ANOTHER SHIP

REPAIR FACILITY. THE CONCEPT OF HAVING SHIP REPAIR WORK COMPLETED IN SHIPYARDS OUTSIDE THE HOMEPORT AREA IS FAR FROM RESOLVED. CONGRESS HAS EXPRESSED CONCERNS WITH THE DEPARTMENT OF NAVY'S EMPHASIS ON GEOGRAPHICAL RESTRICTIONS FOR REPAIR WORK. FURTHERMORE, THE COMMISSION ON MERCHANT MARINE AND DEFENSE, A PRESIDENTIALLY APPOINTED COMMISSION TO STUDY OUR NATIONAL DEFENSE NEEDS, HAS RAISED THIS ISSUE. ARE HOMEPORTS NECESSARY? HOW MANY HOMEPORTS ARE REQUIRED? HOW LARGE A FLEET SHOULD BE STATIONED IN EACH HOMEPORT TO ENSURE AN ADEQUATE NUMBER OF SHIPYARD FACILITIES?

THE MAJOR PROBLEM, IN OUR VIEWPOINT, IN SEGMENTING THE SHIP REPAIR INDUSTRY ACCORDING TO THE CURRENT NAVY HOMEPORT PROGRAM IS THE HOMEPORT PROGRAM ITSELF. THIS PROGRAM, SINCE ITS CONCEPTION, HAS BEEN CONTROVERSIAL. THE HOMEPORT PROGRAM IS PRESENTLY IN A CONTINUING STATE OF UNCERTAINTY. THE POTENTIAL MAJOR CHANGES TO THE HOMEPORT PROGRAM MAKE IT LUDICROUS TO LINK THE TWO TOGETHER UNDER PRESENT CIRCUMSTANCES. UNTIL ALL CHANGES ARE SORTED OUT, AND THE PROGRAM IS FULLY AUTHORIZED AND FUNDED, SBA SHOULD DELAY CONSIDERING THIS GEOGRAPHIC FORMAT FOR THE SET-ASIDE PROGRAM. AT THIS TIME, A SHIPYARD OUTSIDE A HOMEPORT VIEWS THE PROGRAM SLIGHTLY DIFFERENT THAN ONE IN A HOMEPORT. TIEING THE SET-ASIDE PROGRAM FOR SHIP REPAIR TO THE HOMEPORT PROGRAM AT THIS TIME WILL ONLY ADD TO THE CONFUSION, UNPOPULARITY, AND POSSIBLY SLOW DOWN FINAL RESOLUTION.

FURTHERMORE, IT IS OUR BELIEF THAT TYING THE GEOGRAPHICAL SEGMENTATION OF THE SHIPBUILDING STANDARD TO THE NAVY HOMEPORT PROGRAM WILL PROVE TO

BE DISASTROUS IN THE LONG RUN FOR TWO VERY IMPORTANT REASONS. ONE, IT IS A PROGRAM DEPENDENT ON CONGRESSIONAL FUNDING. AND, TWO, IT ALSO REPRESENTS A MARKET STRUCTURE BASED ON ONE CONTRACTOR'S NEEDS RATHER THAN INDUSTRY STRUCTURE. WE DO NOT FEEL THAT A GOVERNMENT CONTRACTOR SHOULD BE ALLOWED TO DICTATE THE MARKET STRUCTURE OF ANY INDUSTRY, PARTICULARY THE SHIPBUILDING AND REPAIR INDUSTRY WHICH IS STILL ATTEMPTING TO RECOVER FROM A SEVERE ECONOMIC DEPRESSION.

A SIZE STANDARD PROGRAM DESIGNED ON SBA'S PREMISE WOULD PROVE TO BE A VERY CONFUSING PROGRAM FOR BOTH THE INDUSTRY AND GOVERNMENT PERSONNEL INVOLVED. EVEN SBA AGREES. IN THE AGENCY'S FEB. 28, 1986, FEDERAL REGISTER RELEASE (51 FR 7077) OUTLINING ITS FINDINGS OF THE 1985 STUDY, SBA STATED "FURTHER SUBDIVISION BASED ON REGIONAL VARIATIONS COULD LEAD TO THOUSANDS OF DIFFERENT SIZE STANDARDS WITH GREAT ADMINISTRATIVE DIFFICULTIES AND CONSIDERABLE CONFUSION. MOREOVER, INEQUITIES WOULD ARISE SINCE ARBITRARY GEOGRAPHICAL LINES WOULD DEFINE SIZE STANDARDS, AND FIRMS IN ONE AREA OF THE NATION WOULD BE TREATED DIFFERENTLY FROM FIRMS IN ANOTHER AREA IN THE SAME INDUSTRY. THERE IS A QUESTION WHETHER SUCH AN UNEQUAL TREATMENT WOULD BE LEGAL. FROM AN ECONOMIC STANDPOINT, FIRMS MIGHT BE MOTIVATED TO CHANGE THEIR AREA OF OPERATIONS SIMPLY BECAUSE OF SIZE STANDARD DIFFERENCES AND THIS WOULD BE UNFORTUNATE FROM SBA'S POINT OF VIEW. FOR THESE VARIOUS REASONS, SBA WOULD BE VERY RELUCTANT TO CONSIDER REGIONAL SIZE STANDARDS EVEN IF IT COULD BE SHOWN THAT SIGNIFICANT REGIONAL DIFFERENCES EXIST."

FINALLY, IF ALL OUR ARGUMENTS AGAINST SUCH A PROGRAM SHIFT ARE UNSUCCESSFUL, AND SBA STILL CONCLUDES THAT GEOGRAPHICAL SEGMENTATION IS WARRANTED, WE WOULD ENCOURAGE SBA TO POSTPONE SUCH ACTION UNTIL AFTER THE POTENTIAL HOMEPORT REALIGNMENT IS REALIZED AND AN EXTENSIVE ECONOMIC IMPACT ANALYSIS ON THE REGIONALIZATION CONCEPT IS CONDUCTED. WITHIN THE FRAMEWORK OF THE IMPACT ANALYSIS, WE FEEL THE FOLLOWING QUESTIONS SHOULD BE EMPHASIZED: WOULD SBA BE REQUIRED TO LOWER THE SIZE STANDARD FOR SHIP REPAIR ACCORDING TO GEOGRAPHICAL REGION, AND IF SO, WHICH METHOD WOULD THEY USE? HOW MANY CONTRACTS WOULD BECOME UNRESTRICTED AS A RESULT? ACCORDING TO REGION, HOW MANY "NEW" SMALL SHIPYARDS WOULD BE ABLE TO BID? TAKING THE CURRENT COMMERCIAL MARKET INTO CONSIDERATION, HOW MANY OF THESE SHIPYARDS WOULD BE FORCED TO CLOSE THUS FURTHER SHRINKING THE SHIPYARD MOBILIZATION BASE? WOULD SBA DESIGNATE A NEW GEOGRAPHIC REGION REPRESENTING INLAND SHIPYARDS? WHAT WOULD BE THE IMPACT OF ALL GOVERNMENT AGENCIES INVOLVED IN SHIP REPAIR WORK FOLLOWING SUCH A REGIONAL PROGRAM? SBA NEEDS TO CONDUCT AN EXTENSIVE MARKET ANALYSIS OF EACH AND EVERY GEOGRAPHICAL AREA.

IN CONCLUSION, WE THE MEMBERS OF THE AMERICAN WATERWAYS SHIPYARD CONFERENCE STRONGLY OPPOSE ANY ATTEMPT TO SEGMENT THE SHIPBUILDING AND SHIP REPAIR SIZE STANDARD BY GEOGRAPHICAL REGIONS. THE SMALL BUSINESS ADMINISTRATION HAS NOT PRESENTED SUFFICIENT INFORMATION TO INDICATE THE NEED FOR SUCH A DRASTIC CHANGE IN THE IMPLEMENTATION OF THE SET-ASIDE .

PROGRAM FOR SHIPBUILDING AND SHIP REPAIR ACTIVITIES. FURTHERMORE, THE SIZE STANDARD FOR BOTH ACTIVITIES SHOULD BE RETAINED AT THE CURRENT LEVEL OF 1,000 EMPLOYEES. THE OTHER REFORMS TO THE SBA SET-ASIDE PROGRAM SHOULD SERVE TO TIGHTEN UP THE ENFORCEMENT AND ADMINISTRATION OF THE PROGRAM TO ENSURE THAT ALL INDUSTRY SECTORS HAVE AMPLE OPPORTUNITY TO PARTICIPATE.

THANK YOU. I WOULD BE HAPPY TO ANSWER ANY QUESTIONS AT THIS TIME.

MBELDEF
Minority Business Enterprise Legal Defense
and Education Fund, Inc.

ADVISABILITY AND FEASIBILITY OF IMPLEMENTING SECTION 921 OF PUBLIC LAW 99-591 AND 99-661

I. INTRODUCTION

Public Laws 99-591 and 99-661 required the Small Business Administration (SBA) to conduct a study of the "Advisability and Feasibility of Implementing" certain amendments to the Small Business Act. These two public laws contained certain identical provisions which modify the procurement assistance programs authorized by the Small Business Act as implemented by the Small Business Administration to encourage the participation of small and small disadvantaged businesses in the federal procurement process. In response to the request of the Subcommittee on Government Contracting and Paper Work Reduction of the United States Senate, the Minority Business Enterprise Legal Defense and Education Fund, Inc., (Legal Defense Fund) has prepared the following comments with respect to the seven areas reviewed by the Small Business Administration pursuant to the requirements of the two above referenced public laws.

II. Objectives of the SBA study.

In evaluating the effects of public laws 99-591 and 99-661 on the various SBA programs, SBA carried out a number of research efforts as alluded to in its two volume report dated July 14, 1987 submitted to the Committee on Armed Forces and the Committe on Small Business, U.S. House of Representatives and the Committee on Armed Services and the Committee on Small Business of the United States Senate. Although the Legal Defense Fund does not disagree with the research approach undertaken by the Small Business Administration with respect to the matters which it was required to address, it is fairly obvious that the Small Business Administration should have placed greater emphasis on conducting interviews, surveys, etc. with the parties which would be most directly affected by any amendment to the Small Business Act; that is, the small disadvantage businesses which are currently pursuing the type of assistance addressed in the study and also the Small and Small Disadvantage Business Enterprises which have recently graduated from, the Small Business Administration 8(a) program. Such firms have a wealth of knowledge based on actual experience attempting to operate a business within the parameters of the laws and regulations affecting the small business program and would have valuable insight to offer SBA as well as the Congress regarding the impact of legislation on future program efforts. We urge the SBA to more carefully undertake a research effort which will make the small business and small disadvantage business enterprises a more active participant in the research effort.

Parren J. Mitchell
Founder and Chairman

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Anthony W. Robinson, Esq.
President

III. The seven areas of concern.

The SBA stated in its report that the amendments of public law 99-661 which must be implemented which they expect to have an impact on the SBA program are as follows:

1. Neither the Small Business set-asides nor "8(a)" contracts may be awarded above the "fair market price";

2. The recipients of the Small Business set asides of "8(a)" contracts for services must perform at least 50% of the cost of the contract with their own employees, 50% of non-material costs in the case of manufacturing, and an amount to be determined by SBA in the case of construction or any other industry not covered by the Statute;

3. The annual goals of each procuring agency, established under section 15 (g) of the Small Business Act, will be premised upon all awards, rather than upon those above $10,000;

4. The objective of achieving a fair proportion of Government contracts for small business is now directed at each Standard Industrial Classification (SIC) code industry, rather than at the totality of Government procurement, as previously held;

5. Size standards for small business eligibility will be based on SIC industries, by law;

6. Contracting Officers will be required upon request, to provide a list of expected small business offerors when a small business set-aside is made; and

7. Size standards in the industries of construction, architectural and engineering services, ship building and repair, and refuse systems and related services are to be adjusted to assure that small business set-asides and "8(a)" contracts do not account for more than 30% of awards in each industry.

IV. Minority Business Education and Legal Defense Fund Comments.

1. "Fair Market Prices".

Although the legal defense fund does not disagree with SBA's conclusion with respect to utilizing the various FAR references (FAR 19.806-2, 14.47-2 and 15.802), it is clear that there is no definitive standard with respect to what constitutes "Fair Market Price". In this regard, SBA's decisions to consider the term "Fair

Market Price" synonymous with "reasonable price" is appropriate; however, "reasonableness" should be construed in connection with the types of businesses that are involved in the various SBA programs; that is, small and small disadvantage businesses whose cost of doing business are often higher than majority contractors, simply because the buying power of such businesses preclude them from obtaining goods, services, and materials with large quantity discounts which would enable them to reduce their costs comparable to the cost of larger businesses. A reasonableness standard should be factored into SBA's review process to indicate that notwithstanding the perhaps higher cost of small and small disadvantage businesses for performing the same of similar activities, contracts may still be reasonable in view of the type of business entity.

2. "50% rule".

On surface, the 50% rule appears to be a valid standard. One of the main problems with the 8(a) and other such programs in the past has been the "front" firms which prevent valid firms from obtaining their "piece of the assistance pie". Accordingly, there is a need for some monitoring of this type of activity to ensure that companies which represent themselves as small and small disadvantage firms are appropriately classified as such pursuant to applicable law and regulations. Even so, the 50% rule should not be a rigid standards as SBA alluded to in Section 4 of its report. In its report, SBA refers to numerous size appeal cases indicating that depending on the type of involvement a so called small firm has with a large firm it will determine that it could possibly determine that a "Joint Venture" type arrangements exist therefore making the alleged subcontract suspect. Such an approach should be on an exception basis.

The Legal Defense Fund suggests that the 50% rule should not only be a standard determined on a case - by - case basis, but also it should allow for a declining percentage scale. In otherwords, the standard should allow for a larger firm, i.e. the subcontractor, assume a large percentage of a contract a the outset and then the percentage decreases so that by the end of the contract the small firm (the prime contractor) is actually performing 50% of the work utilizing it's own forces.

The rationale for the declining percentage approach is that quite often, particularly in the case of an 8(a) firm, a company will be successful in obtaining a contract; however, it may not have the resources (financial, number of employees, etc.) to take on the start up phases of a contract.

The Legal Defense Fund recognizes that such a declining approach may not be appropriate for all assistant programs of SBA, but it is a mean of allowing small firms to get started in major procurement activity without the financial risk associated with starting up a government contract.

3. "Goaling".

The Legal Defense Funds supports the concept of goaling and believes that goaling enhances small and small disadvantage business participation in the federal assistance process.

4. "Fair proportion by SIC".

The Legal Defense Funds believes that the only valid way of ensuring that small and small disadvantage businesses adequately participate in government assistance programs is that buying agencies make every effort on an individual industry-by-industry basis to ensure that such businesses receive their fair share of each product and service being purchased. Otherwise, procurement to small and small disadvantage businesses will be concentrated in a few industries where small and small disadvantage businesses have historically received a large percentage of the federal dollar. Such activities do not enhance the ability of small and small disadvantage businesses to actively and properly participate in the SBA and other programs of the federal government designed to enhance their capability, but actually forces them to pursue only certain types of functions and certain types of businesses.

5. "The SIC System for establishing size standards".

SBA has historically utilized the SIC system for classifying business opportunities for small and small disadvantages businesses. The rationale appears to be that there are no other valid standards of similar effect. The Legal Defense Fund does not necessarily disagree with the use of the SIC for classifying businesses; however, the SIC should not be utilized as a rigid standard which precludes firms, due to natural growth being prevented from obtaining contracts which they have marketed and pursued utilizing their own resources consistent with the objectives of the SBA programs. Example, if a SIC code for a given industry is based on the average gross receipts for a three year period, it is foreseeable that if a firm performs well under existing contracts and is awarded an additional contract, that it's gross receipts over an average basis may exceed the SIC for the type of industry in which the firm operates. In such a situation, if the firm can verify that it has actively pursued a given opportunity, then the small and small disadvantage business firm should not be precluded from contract award if the only reason is that it no longer fits within the SIC parameters. Obviously, once a firm reaches the SIC ceilings, then it should be restricted from pursuing future work; however, for work which is already in the procurement process, the contract should not be denied simply because natural growth occurred before a contract was signed.

5. "Size Standards based on SIC".

   (See Comments to Number 4 above).

6. "Listing of Candidate firms for set-aside".

   The Legal Defense Fund concurs with SBA's conclusion that such a requirement will place an increased burden on contracting personnel in all federal agencies which would detract from the use of set-asides, to the overall detriment of the small and small disadvantage business community.

7. "The 30% rule".

   The Legal Defense Fund has no comment concerning the conclusion reached by the small business administration in this area.

V. Summary and Conclusion.

As alluded to above, the report of the Small Business Administration leaves open many issues which need to be addressed with respect to small and small disadvantage businesses being able to actively participate in federal assistance programs. In this regard, what is needed is an overall consistent monitoring process to evaluate the effectiveness of the new amendment on SBA's program. Included in this monitoring process, is the participation of not only the small and small disadvantage businesses which are presently capable of participating in the various programs of SBA, but also the involvement of firms which have either graduated from various SBA programs such as the 8(a) program, or who are no longer actively pursuing small and small disadvantaged business set-aside type contracts. These firms have experience in trying to live within the parameters of the SBA regulations and other guideline, which should be shared and considered as far as determining the effectiveness of these and other amendments of small business programs in general.

Testimony of
H. Robert Saldivar
Director, Office of Procurement and Supply
Veterans Administration
BEFORE
Subcommittee on Government Contracting and Paperwork Reduction
Senate Committee on Small Business
September 21, 1987

Mr. Chairman, I am H. Robert Saldivar, Director, Office of Procurement and Supply, Veterans Administration. Thank you for this opportunity to testify regarding the impact that recent amendments to the Small Business Act enacted by Public Law No. 99-661 (hereinafter referred to as P.L. 99-661) will have on the Veterans Administration's procurement programs. As a major purchaser of medical supplies, pharmaceuticals, subsistence commodities, and services, including construction, the Veterans Administration relies heavily on small and small disadvantaged suppliers. Some of our most reliable supply sources are small business concerns. It is in our interest to have continued easy access to these fine domestic sources of supplies and services.

We are familiar with the intended improvements in the Small Business Administration's policies and regulations which are mandated by the recent legislation. We applaud the efforts to reduce the potential for abuse of these programs and selective modification of size standards for industry categories in which a disproportionate share of the procurements are awarded to small business concerns. Unfortunately, we also are concerned that implementation of the proposed provisions will significantly increase the administrative burdens associated with small business procurement programs. In total, the application of some of these new policies and procedures may tend to reduce procurement opportunities for the small business sector.

The Veterans Administration has embarked on several exciting and ambitious procurement initiatives in this fiscal year. We are increasing the professionalism of our contracting work force through the establishment of a Contracting Officer Certification Program. We are also pursuing several cost-effective and quality enhancing procurement techniques relying primarily upon our consolidated Agency-wide buying power. At the same time, the VA is aware of the need to further social and economic objectives, attested to by the very ambitious goals we strive to meet each year. This fiscal year our goals for the small business program and the 8(a) program are $782,255,000 and $117,123,000 respectively. For small business, the goal equates to 41 percent of the total dollar of procurement actions exceeding $10,000 and for the 8(a) program, the goal equates to almost 4 percent of the total procurements in our base within the VA. Our goals for Labor Surplus Area set-asides, minority prime contracts, women-owned business and subcontracting programs are equally ambitious.

Several acquisition related aspects of P.L. 99-661 provide needed procurement procedural improvements. The general raising of the threshold to $25,000 for synopsizing in the Commerce Business Daily is consistent with procurements in this category being processed under "simplified small purchase procedures."

The modification of the annual participation goals in section 921(d) to include procurement actions of less than $10,000 provides us an opportunity to further emphasize small purchase procurements in small business goal attainment. On the other hand, we believe that some provisions of P.L. 99-661 will diminish the dollars the VA awards to small and small disadvantaged business concerns. Our analysis of the legislative history of P.L. 99-661 indicates that some of that diminishment may be intentional, but some of it may be inadvertent.

Perhaps the most troubling provision of the legislation is section 921(b) Awarding of Contracts at Fair Market Prices. If this provision is strictly implemented as a statutory requirement, it may prove most damaging to the 8(a) program. We cannot agree with the SBA Report analysis* which concludes that this section will have little impact upon its programs. This conclusion is primarily drawn upon the premise that the term "fair market price" and "reasonable price" are synonymous. However, the Joint Explanatory Statement of the Committee of Conference reflects an intent to use the definition of "fair market price" contained in the FAR, which defines it as an estimate "based on reasonable costs under normal competitive conditions and not on lowest possible costs." See 48 CFR Section 19.806-1 (1986) (emphasis added). While this definition may not have an adverse impact upon the small business set-aside program, which is itself a competitive procedure, we believe it will impair the 8(a) program since that program is clearly intended to assist firms not yet able to effectively compete in the market place. For this reason, the VA had previously deviated from the FAR by allowing our contracting officers to make 8(a) contract awards at reasonable prices rather than the fair market price as defined in FAR Section 19.806-1. *See* 48 CFR Section 819.806-2 (1986). However, in order that we may be in compliance with the statutory effective date of October 1, 1987, of P.L. 99-661, we are processing a rescission of that deviation. Consequently, we believe 8(a) contract opportunities in the VA will be reduced unless SBA is able to more adequately utilize its Business Development Fund for subsidizing the difference between the proposed price of an 8(a) concern and the fair market price. Recommendations pertaining to S. 1559 contained later in this testimony address how this obstacle to 8(a) contracting may be overcome.

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*Volume I, Advisability and Feasibility of Implementing Section 921 of Public Laws 99-591 and 99-661, July 14, 1987.

We have already established a reporting system which will be used to assess the actual impact section 921(b) will have upon the VA 8(a) program. We also are developing several initiatives, including requesting SBA to allow limited competition among 8(a) firms and establishing a VA Acquisition Regulation prescribing a collaborative relationship with SBA in developing the fair market price. We hope these efforts will at least minimize the adverse impact we foresee.

We are further concerned with the administrative feasibility, as well as the impact upon the small business program, of implementing section 921(a) of P.L. 99-661. This section could be interpreted to require that separate goals be established for each Standard Industrial Classification (SIC) code. However, in conversations with cognizant officials of SBA, they have confirmed that FY 1988 goals will be established on a total dollar basis for small business and small disadvantaged business programs. Section 921(a) provides the foundation for SBA to establish goals by SIC codes in later years. It is our opinion that such a requirement is inadvisable as it would make goaling unwieldy and complex.

Under P.L. 99-661, the VA, in conjunction with SBA, is required by sections 921(a) and 921(d) to assess our small business program accomplishments in each of the SIC codes, ensuring a fair share of our acquisitions flow to each. From an administrative perspective, this assessment requirement, which is to be implemented October 1, 1987, is constrained by the Federal Procurement Data System (FPDS) which will not have SIC capability until October 1, 1988. Beyond that, we believe it will be extremely cumbersome for the procuring agency as well as SBA to monitor small business and 8(a) program accomplishments for hundreds of SIC codes.

We further believe it unlikely that comparable percentage criteria for each SIC code reflect the realities of the market place. There are categories of manufacturing and high technology industries with initial capitalization requirements that virtually preclude entrance of business concerns which could meaningfully be considered small. Procurements in some SIC categories are more often selected for small business set-asides because they are more conducive to small business participation. Small businesses in these industries are more likely to expand and grow with the assistance of the set-aside program. The 30 percent limitation by SIC in section 921(f) will lessen the accomplishments the VA has traditionally achieved in construction and architect-engineer (A/E) services. We currently prescribe a class small business set-aside for construction projects less than $3 million and for the A/E services for such projects. Additionally, a significant amount of construction projects exceeding $3 million are set-aside for small business.

We believe that the SBA monitoring of set-asides by SIC, as is mandated in section 921(f) of P.L. 99-661 for specified industry categories, and a more aggressive approach to proper adjustments to size standards will ensure that the small business set-asides truly assist the targeted business concerns. However, as readily illustrated by Volume II of the SBA report, the size standards for construction will need to be radically altered to bring set-aside awards down to 30 percent. With the current "rule of two" regulation for small business set-asides contained in FAR Section 19.502-2, bringing these categories' accomplishments down may have the unintended effect of diminishing competition for those set-asides allowed by the 30 percent cap to such an extent that the prices paid may be greatly increased. This occurs because of the extreme reduction of qualifying small business firms. Because the VA currently accomplishes a significant portion of its small business and 8(a) set-asides in our construction program, the 30 percent ceiling will reduce our achievements for these programs and our goal will need to be commensurately reduced.

With regard to the subcontracting restrictions contained in section 921(c), the VA generally endorses the need to ensure that set-asides are truly benefiting the intended firms. We believe, however, that the 50 percent performance criteria for A/E firms is much too high. It is common for most A/E firms, and smaller A/E firms in particular, to serve as the prime contractor and to subcontract with engineering consulting firms for work which may comprise over 60 percent of the contract dollar value.

There also are issues in implementing the subcontracting limitations which remain to be addressed and include the following:

- What penalties, if any, are proposed for firms that exceed these limits during performance?
- Does SBA plan to monitor compliance in the same way their subcontracting specialists review performance against subcontracting plans?

- o If fewer small businesses are able to comply with rigid subcontracting restrictions, the opportunities for small business set-asides will diminish.

In summary, we consider P.L. 99-661 to require a very significant change in the 8(a) and small business set-aside programs. In order for the 8(a) program to continue to be viable, we must look at approaches such as fully funding the SBA Business Development Fund to pay for price differentials as defined in the FAR, and the use of competitive procedures in the 8(a) program. With regard to small business set-asides, we can foresee the need to make adjustments to size standards in order to ensure equity in the program. We would suggest that performing an SBA evaluation of the small business criteria for each SIC rather than prescribing a percentage of Federal set-aside dollars for each SIC might be a better and more manageable means of ensuring that the targeted small businesses are reached. In any event, the impact upon socioeconomic procurement performance must be acknowledged, and needed adjustments to Agency socioeconomic goals required by section 15(g) of the Small Business Act must be accommodated.

You have also recently requested an assessment of S. 1559, 100th Congress, 1st Session, which revises some of the provisions of P.L. 99-661. We believe S. 1559 would make the control and implementation requirements of the Small Business Act as modified by P.L. 99-661 more manageable. We do have specific recommendations which we believe will further assist agencies in accomplishing the small business procurement program objectives.

We note that section 2, paragraph (3) of S. 1559 amends section 15(a) of the Small Business Act by changing language which requires that a contract awarded under section 15(a) not exceed the "fair market price" of said contract and instead substitutes language which requires that the contract awarded cannot exceed a "fair and reasonable price." We strongly recommend that this statutory amendment be extended to section 8(a)(1)(A) of the Small Business Act, thereby making this same standard applicable to the 8(a) program. It is the VA's opinion that this standard is even more applicable to the 8(a) program because the definition of "fair market price" reflects a price obtainable under normal competitive conditions and 8(a) business concerns are generally not yet competitive. Consequently, extending the use of "fair and reasonable price" in section 8(a)(1)(A) would provide consistency between the 8(a) and small business set-aside programs and would, more importantly, eliminate a major obstacle to the 8(a) program that will be established should P.L. 99-661 be implemented in its current form.

It appears that section 2, paragraph (2) of S. 1559 should also be revised to read "through the last sentence" in lieu of "up to the last sentence."

We wish to reiterate our support for establishing socioeconomic goals on the basis of all procurement actions, as is specified in P.L. 99-661. Such allowances reflect the important use of small purchase procurements in furthering the objectives of the Small Business Act program objectives. Nonetheless, if a dollar threshold is to be established the $25,000 figure established in S. 1559 is preferable to $10,000 since $25,000 is consistent with the individual contract action reporting threshold established by the FPDS.

The remaining provisions of S. 1559 are considered very valuable refinements of the Small Business Act as amended by P.L. 99-661 and the VA supports them.

This concludes my prepared remarks, and I will be pleased to respond to any questions the Committee may have.

STATEMENT OF
PATRICIA A. SZERVO
ASSOCIATE ADMINISTRATOR FOR ACQUISITION POLICY
GENERAL SERVICES ADMINISTRATION
BEFORE THE SUBCOMMITTEE ON GOVERNMENT CONTRACTING AND PAPERWORK REDUCTION
SENATE COMMITTEE ON SMALL BUSINESS
SEPTEMBER 21, 1987

Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to present for the record, on behalf of the General Services Administration (GSA), our agency's views regarding the anticipated implementation of the amendments to the Small Business Act contained in Public Law 99-661 (effective October 1, 1987), and, in particular, section 921 concerning small business set-asides. I have also been requested to address the Subcommittee on S. 1559, which, if enacted, would modify many of the amendments contained in Public Law 99-661. I would like to comment on five areas of concern raised by the provisions of Public Law 99-661, and then address how these provisions would be affected by S. 1559.

GSA's first concern is with section 921(a) of Public Law 99-661, which amends section 15(a) of the Small Business Act to authorize the use of small business set-aside contracts to assure that small business concerns receive a fair proportion of the total Government purchases in each industrial category. Such industry categories are to be determined by the four-digit standard industrial classification codes published by the Office of Management and Budget in the Standard Industrial Classification (SIC) Manual. Under the current law, such set-asides are authorized in order to achieve for small business concerns a fair proportion of total Government purchases rather than a particular industrial category. We offer two observations concerning this change. First, since GSA does not maintain contract records by SIC code, and the Federal Procurement Data System (FPDS) does not currently require SIC code entries when reporting contracts, GSA will need to establish a manual reporting system to collect information by SIC codes in order to accommodate the small business participation goals outlined in section 15(a) of the Small Business Act. Considering that there are more than 1,000 four-digit SIC codes provided by the OMB Manual, implementation of the new standard will impose an administrative and financial burden upon the agency. Second, it should be noted that the overall number of contracts set-aside to small businesses may be reduced upon implementation of the amendment. This will be particularly true if, as the Report of the Committee on Armed Services of the House of Representatives (H.R. Rep. No. 718, 99th Cong., 2d Session 256-259 (1986)) suggests, a fixed percentage limitation is used to determine what constitutes a "fair proportion" for each SIC code.

Currently, small business awards are not evenly distributed in each industrial category, but may be concentrated in certain categories which, by their nature, provide greater opportunities for small business concerns. This is done to ensure that overall a fair proportion of the Government contracts go to small businesses. As a result of the subject amendment, the number of set-asides in those categories may have to be reduced in order to achieve the fair proportion limitation. However, we may find that we are unable to proportionately increase set-asides in other categories where small business opportunities are not available. The net result may be an overall reduction in the number of set-asides for small businesses.

GSA is also concerned about section 921(b) of Public Law 99-661 which amended section 15(a) of the Small Business Act to preclude an award of a set-aside contract which would result in a cost which exceeds a "fair market price." Currently, a Federal contracting officer must ensure that a set-aside award under section 15 of the Small Business Act will result in a "fair and reasonable price" to the Government. This pricing standard, which is common to all Federal contract awards and well understood by Government contracting personnel, may be determined by resorting to a number of analytical techniques which are provided for in the Federal Acquisition Regulation. In procurements, such as section 15(a) set-asides, the most important indicator of price reasonableness is the comparison of prices received as a result of adequate price competition. Where such competition exists, the contracting officer may generally presume price reasonableness. However, other techniques, such as comparison of prior contract prices, the use of rough pricing yardsticks, comparison with published price lists or market prices, and comparison with Government estimates are available as necessary. The amendment's introduction of a "fair market price" standard is, in our view, unnecessary to ensure fair pricing in section 15(a) set-asides. Furthermore, the use of a term which is currently associated with noncompetitive section 8(a) contracts may serve only to confuse contracting officers and cause a more complex and time consuming price analysis than is appropriate for a competitive procurement.

A third concern of GSA is with section 921(c) of Public Law 99-661, which requires that a small business concern agree, as a condition to either a set-aside award under section 15(a) or section 8(a) of the Small Business Act, to perform in-house at least 50 percent of the personnel costs for a service contract or 50 percent of the cost of manufacturing in a supply contract. Although GSA understands that the intent of the requirement is to prevent abuse of the set-aside programs, we are concerned that, in the area of manufacturing, some small businesses to may not be able to estimate and segregate anticipated costs with a reasonable degree of certainty so as to comply with this requirement. From GSA's perspective, we are also concerned about the administrative costs incident to the enforcement of the new requirement. GSA's contract administration and audit resources are limited and are currently fully occupied in ensuring the delivery of quality products and services in accordance with the current terms of our contracts. The new requirement, if effectively enforced, will increase the contract administration burden.

Section 921(e) of the statute amended section 15(p) of the Small Business Act to require the release of certain information on those small business firms, which a contracting officer expects to respond to a set-aside procurement. The requirement is likely to add to GSA's administrative burden without any meaningful benefit. Additionally, we note that the five day response time required by section 921(e) is unreasonably short and may detract from more important agency activities.

An additional concern pertains to section 921(f) of Public Law 99-661 which requires that the Small Business Administration establish a program for the review of size standards for determining small business eligibility in procurements under sections 8(a) and 15(a) of the Small Business Act. The law would further require an adjustment of the size standards in certain industry categories, if it were found that contracts awarded under the set-aside programs exceeded 30 percent of the dollar value of total contract awards for an industry category. It appears that the intent of the requirement is to set a standard for determining a "fair proportion" of contracts in the designated industry categories and to control the level of set-aside contracting by adjusting the number of businesses eligible for participation in the set-aside programs.

We question whether adjustments to eligibility standards will in fact have the desired effect of effectively controlling the proportions of set-aside awards within each category. For example, reducing the potential pool of eligible small business concerns within an industry category from three hundred to two hundred will not necessarily result in fewer small business set-aside awards. Finding the perfect balance in order to achieve but not exceed the 30 percent goal is likely to be a long and resource consuming process which will require constant readjustment by SBA. In our view, if the 30 percent standard is not to be exceeded, agencies will have to develop means of controlling the number of set-aside awards.

Turning to Senator Dixon's bill, we note that enactment of S. 1559 would eliminate many of GSA's concerns with the previously discussed provisions of Public Law 99-661, but not all.

Section 2 of S. 1559 would amend section 15(a) of the Small Business Act to delete the reference to "each industry category" and substitute the language "of the total awards (utilizing the product and service codes of the Federal Procurement Data System . . . .)", with the purpose of this change being to restore the prior status of the law on the distribution of set-asides. GSA, however, suggests three modifications to achieve this goal. First, GSA recommends the deletion of the phrase "in each industry category" without the insertion of additional language. This would reestablish precisely the language of section 15(a) of the Small Business Act that existed prior to Public Law 99-661. Second, GSA is concerned that S. 1559 would not repeal the section 3(a)(3) and (4) of the Small Business Act. Failing to repeal this provision may thwart a restoration of the prior law, since it displays a clear intent to impose a ceiling on set-asides in certain categories, leaving the problems raised earlier. GSA believes that the repeal of this section of Public Law 99-661 would be in the best interest of the set-aside program. Finally, GSA recommends that section 15(g) of the Small Business Act be amended to delete the reference to small business participation by industry category inserted by Public Law 99-661. Such an amendment would be consistent with the other changes proposed by S. 1559, would relieve the administrative burdens likely to be encountered in order to meet the Small Business Act's objectives, and would help restore the prior law.

To conclude, GSA makes these concerns known in hopes of assisting the continuation of a strong and viable small business and small disadvantaged business program. While we support the intent behind legislative initiatives designed to improve the Federal procurement programs that aid these businesses, we envision a number of practical problems in implementing the requirements of Public Law 99-661 as they pertain to these programs. The enactment of S. 1559 would remedy many, but not all, of these problems. S. 1559 does relieve GSA's concerns regarding the utilization of the term "fair market price," the 50 percent in-house requirement, and the release of information. GSA therefore supports the enactment of S. 1559.

Thank you for the opportunity to present our agency's views.

Testimony of

WASTE MANAGEMENT, INC.

Prepared for

The Committee on Small Business
United States Senate

September 21, 1987

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Waste Management, Inc. appreciates the opportunity to offer its comments on the set-aside programs and recent amendments thereto. Waste Management fully supports the policies adopted by the Congress in 1953 that led to the creation of the set-aside programs and believes those polices are as relevant and important today as they were 35 years ago. Waste Management remains concerned, however, that actual implementation of those policies has somehow been lost or forgotten by many federal agencies in an effort to meet artificial goals that do not have any relationship with the basic policies established by Congress. We are hopeful that this examination of the operation of the set-aside programs by the Small Business Committee will help reestablish the importance of those basic goals and the order of priorities in the set-aside programs.

As discussed in detail below, Waste Management views the most recent amendments to the Small Business Act as a critical and important, but somewhat flawed effort, to achieve the basic policy objectives of participation by small business concerns in the federal marketplace. Waste Management recommends that SBA be directed to implement the clear intent of Congress that set-aside contracts be awarded at a fair market price. In addition, Waste Management recommends that a pilot program for a limited number of industry categories be established.

A pilot program, with a Congressionally mandated small business concern participation goal based upon a percent of total federal contract dollars spent for contracts over $25,000, would help eliminate the current practice of "loading" certain low-tech service industry categories with a high percentage of set-aside contracts. It would encourage federal acquisition personnel to assist a broad industry spectrum of small business concerns in the Government marketplace while recognizing that in certain industry categories, such as garbage collection services, small business concerns are already winning 50 percent of the Government contracts awarded based upon full and open competition. Waste Management looks forward to working with the Small Business Committee on these efforts.

Background

Waste Management and its subsidiaries form a full service network of refuse systems and related services. Waste Management currently operates in 39 states as well as in 6 foreign countries providing high quality service in all aspects of refuse management at competitive prices. In addition, Waste Management companies currently compete and serve as contractors for all types of Government contracts dealing with refuse systems and related services.

Waste Management competes on a daily basis with the many small businesses that make up the refuse collection marketplace. Due to certain economic features and capital requirements the refuse collection marketplace consists of a large number of very small refuse collection companies and a more modest number of larger refuse collection companies. Small Business Administration (SBA) statistics indicate that of the companies operating under the Standard Industrial Classification code 4212 which includes the collection and transporting of garbage and refuse, well over half (59 percent) of those companies have average annual sales of under $138,000 and have 4 or fewer employees. See Attachment 1. Those same statistics indicate that of the 33,995 firms operating under SIC code 4212, almost all (99 percent) are classified as small business concerns under current small business size standards for refuse collection. Id.

SBA statistics also indicate that in SIC code 4953, the code under which Waste Management operates because of the nature of its refuse disposal services, nearly two-thirds (65 percent) of the companies have annual sales of less than $381,000 and have 9 or fewer employees. Of the 2785 firms operating under SIC code 4953, almost all (98 percent) of the firms are classified as small business concerns under current small business size standards.

The point to be made by these statistics is that Waste Management understands the competitiveness of small business refuse companies and has an appreciation of their ability to compete and be successful in the commercial marketplace. Waste Management competes on a daily basis with those small business concerns in a highly competitive environment dependent on both quality service and competitive prices.

Historical Reference

The small business set-aside programs are based on Congressional policy that dates back to the Armed Service Procurement Act of 1947. That Act provided that small business concerns were to receive a "fair proportion" of defense-related government contracts and purchases. According to legislative history, the set-aside programs are part of an overall Congressional effort of offering assistance to small business concerns unable to compete effectively in the marketplace. The intent of those efforts, as stated in the Congressional report of the legislation establishing the Small Business Administration in 1953, is to help those firms become self-sufficient, viable businesses.

Congress expanded the scope of the set-aside programs in 1958 to allow a "fair proportion" of all Government contracts to be awarded to small business concerns. This addition was intended to put the set-aside program on a peacetime basis, permitting assistance to be given without regard to any relationship to the maintenance of full productive capacity or to war or civil defense programs. As a result, small business concerns are to be assisted by federal agencies by being awarded federal contracts upon the determination that it would:

> be in the interest of maintaining or mobilizing the Nation's full productive capacity...be in the interest of war or national defense programs...be in the interest of assuring that a fair proportion of the total purchases and contracts for property and services for the Government are placed with small business concerns...[or] be in the interest of assuring that a fair proportion of the total sales of Government property be made to small business concerns.

(Emphasis Added).

Current Set-Aside Practices

Management of the set-aside programs has generally been left to the SBA and federal contracting agencies. Congress has, on occasion, added statutory instruction dealing with the implementation of the program. These additions have dealt with surety requirements, eligibility of not-for-profit organizations; priority of labor surplus areas; the role of the SBA in establishing goals for participation by small business concerns; annual reports; the set-aside of small purchases; the establishment of Offices of Small and Disadvantaged Business Utilization; and the assignment of breakout procurement center representatives. The intent of these amendments has been to focus further the attention of federal agencies on the set-aside program and to increase participation by contracting agencies.

One of the changes that has had the most profound effect on the set-aside program was the requirement that each federal agency establish, after consultation with the SBA, overall agency goals for the participation by small business concerns in agency acquisitions. In addition, creation of a specific high-level office to deal with small business issues within each agency has also added to the pressure on agency acquisition officials to set aside an increasing number of contract dollars each year for exclusive small business concern participation.

In this rush to meet yearly goals, agencies have, for the past several years, increased the practice of "loading" certain industry categories with a high percentage of set-aside contracts while failing to make the effort to ensure that small business concerns in other industry categories receive a fair share of federal contracts. For example in FY 1986, according to Federal Procurement Data System data produced at SBA's request, there were 645 Product and Service Code (PSC) categories with more than 25 initial contract actions.

In 46 of the 645 PSC categories, more than 70 percent of the total procurement dollars were set aside for exclusive participation by small business concerns. The set-aside contracts in those 46 PSC categories made up almost one-fifth (17 percent) of the total set-aside dollars awarded in FY 1986. However, in 279 of the 645 PSC categories, less than 10 percent of the total contract dollars were set aside for small business concerns. Although those 279 categories make up almost half of the categories reviewed, they account for only 22 percent of total set-aside dollars awarded in FY 1986.

The same set of data also show that it is the low-tech service and product industry categories that are being used to meet small business concern participation goals while more sophisticated industry categories such as research and development contracts are almost never awarded based on the set-aside programs. For example, as indicated in Attachment 3, of the 46 PSC categories with more than 70 percent of the total contract dollars awarded under the set-aside programs, 35 PSC categories are for services and only 9 are for products. Furthermore, of the 35 PSC service industry categories, 29 are classified either as "Housekeeping Services," (4); "Construction of Structures and Facilities," (9); or "Maintenance, Repair, or Alteration of Real Property," (16).

Of the 9 PSC product categories in the same 70 percent or above set-aside range, 4 are classified as "Clothing, Individual Equipment, and Insignia" and 2 are classified as "Textiles, Leather, Furs, Apparel and Shoe Findings, Tents and Flags." At the same time, contract dollars spent for technical services and products are set aside only sporadically. For example, 80 percent of the research and development contract dollars were set-aside less than 10 percent of the time in FY 1986.

What these data indicate is that the set-aside programs are currently being used to meet numerical goals rather than achieve policy objectives. A fair conclusion to reach is that the federal Government is using its resources to a much greater degree to assist small business concerns in the low-tech service industries in an effort to meet goals rather than using its resources to help a broad base of small business concerns such as those small businesses attempting to compete in the more sophisticated industry categories like research and development.

In 1983, this agency practice of loading certain industry categories with set-aside contracts was challenged in court. In J.H. Rutter Rex Manufacturing v. United States, 706 F. 2d 702 (1983), a manufacturer of military clothing, having gradually lost between 1976 and 1981 all of its Government business due to set-aside contracts, brought suit against the Department of Defense for allocating over 90 percent of its contracts for apparel to small business concerns. The manufacturer argued that such a high percentage of set-asides violated the statutory requirement that a "fair proportion" of contracts be reserved for small businesses.

The Fifth Circuit, in upholding a lower court decision, could not find any statutory language or legislative history to support the manufacturer's contention that Congress intended a "fair proportion" of contracts to be reserved for small business concerns in each industry category. The Court held that because Congress had delegated broad powers to agencies to achieve statutory purposes in procurement matters and had not clearly objected to agency practices of setting aside a large percentage of contracts in certain industry categories, no violation of statute occurred where DOD set aside 90 percent of all apparel contracts.

Recent Congressional Action

Although the Rutter Rex decision served to validate agency "loading" activities, Congress has more recently concluded that such loading efforts create problems and undesirable results. The first problem found by Congress is that by setting aside the majority of federal contracts in a particular industry category, there is little incentive for small business concerns that are active in the federal marketplace to grow beyond the size limit established by the SBA. Indeed, in such an industry category, a decision to grow also becomes a decision to abandon the federal marketplace which is often the very marketplace that permitted the growth in the first place. This results from the simple fact that small business concerns that grow to exceed the SBA size standard will no longer be eligible for the contract work being set aside.

A second problem is created when small business concerns that are near the actual level of the size standard make the decision to remain as "big" small business concerns by carefully avoiding any expansion that would remove them from the classification as a small business concern. In an industry category where the current size standard is fairly high, these "big" small business concerns have the best of both the Government and commercial marketplaces; they are often better situated to compete with truly small business concerns for Government contracts that are set-aside, and at the same time can often compete successfully with large businesses for those federal contracts that are not set-aside and for contracts in the commercial marketplace. As a result, a permanent class of "big" small companies is created that take advantage of the set-aside programs while frustrating the Congressional purpose of helping small companies that are effectively unable to compete.

A third problem created by loading industry categories is the resulting "gaming" of contract work and business data to ensure that a particular size standard is not exceeded. This is done by business concerns either hiding affiliations and assets that actually make them a large business or by subcontracting a substantial portion of the work on federal contracts to large businesses. Because the current regulations permit contract awards at a price above a fair market price, a small business concern can afford to pay a large business subcontractor a fair market price to accomplish nearly all of the contract work while still making a profit and without doing any of the work or gaining any competitive experience.

A fourth problem area results when a small business concern is unprepared to handle a particular Government contract but is nevertheless encouraged by a contracting officer interested in meeting a set-aside goal to bid on the contract in order to provide a sufficient number of small business competitors to set aside the contract. The result in this instance is that either the small business concern submits an unrealistically high bid resulting in inefficient and costly competition and contract awards or, even worse, and unqualified small business concern is awarded the contract and ends up defaulting on the contract. The small business concern loses by having to pay the business costs associated with contract default and the Government loses by having to find a short term contractor capable of performing the work, usually at sole source prices.

A final problem area associated with the practice of loading is the fact that large businesses are excluded from the Government marketplace regardless of technical capability or price competitiveness. This limits competition for the contract and can serve to increase prices paid by the Government for products and services.

In order to address the problems that have been created by loading practices while still maintaining the objectives of the set-aside program to assist small business concerns unable to compete effectively, Congress, last year, amended the basic set-aside programs. Those amendments accomplished four basic goals.

First, they established the clear statutory policy that a fair proportion of contracts were to be set aside in each industry category. This was done by reference to the Standard Industrial Classification codes developed by the Department of Commerce.

Second, they established that set-aside contracts were to be awarded at a "fair market price."

Third, they limited subcontracting by small business concerns awarded a set-aside contract to no more than 50 percent of the work to be performed.

Fourth, they established a pilot program in 4 industry categories: Construction; Architectural and Engineering services (including surveying and mapping services); Shipbuilding and ship repair; and Refuse systems and related services. Congress required SBA to reduce the size standards in those 4 categories until no more than 30 percent of the total contract dollars awarded by the federal government was awarded based on the set-aside programs.

Unfortunately, due to data collection problems as well as inappropriate interpretation by SBA staff of the legislative language and intent, the objectives of the 1986 amendments have not been met.

Fair Market Price

As part of the 1986 Amendments, Congress addressed the problem associated with the uncertain regulatory standard that set-aside contracts may be awarded at a "reasonable price" by requiring that such contracts be awarded at a "fair market price." This change was necessitated by the lack of any specificity and varying interpretations in determining what constitutes a "reasonable price." The change was intended, as indicated by the House Report "to ensure some uniformity by acquisition personnel when assessing the acceptability of a set-aside offer."

Under the current regulations, a contracting officer may set aside a contract if "there is a reasonable expectation that (a) offers will be obtained from at least two responsible small business concerns...and (b) awards will be made at reasonable prices." FAR, 48 C.F.R. § 19.502-2. There is no existing regulatory requirement that the price offered by a small business concern be equal to or better than prices that could be received through unrestricted competition. The Government, as a result, may pay a reasonable "premium" price to small business concerns in order to effectuate the Congressional policy in the Small Business Act. The Comptroller General has concluded that prices higher than Government estimates can be reasonable if necessary to give small business concerns a fair proportion of the total Government contracts and purchases and the determination is made in the public interest.

The reasonableness of the price offered is to be determined by the contracting officer and is subject to broad discretion. Prices 11 percent higher than Government estimates and 51 percent higher than prices submitted by large businesses have been upheld as reasonable by the Comptroller General. At the same time, the Comptroller General has upheld a contracting officer's decision to withdraw a set-aside contract because the price offered by a small business concern exceeded the Government estimate by 7.2 percent. This lack of guidance as to how to determine price reasonableness for set-aside contracts has resulted in unequal and inconsistent treatment of small business concerns as well as other Government contractors.

In its report to Congress on the 1986 Amendments, however, SBA has virtually ignored the new statutory requirement of award at a "fair market price" by reinterpreting that phrase to mean the old standard of "price reasonableness." The SBA report states "that the references to 'fair market price' should be construed as synonymous with 'reasonable price' repealed [sic] and that the existing FAR standards are sufficiently clear to govern both 8(a) and set-aside awards."

SBA attempts to justify this conclusion by comparing the "reasonableness price" standard for unrestricted contract awards to the current "reasonableness" standard used for set-aside contracts. The determination of reasonableness for unrestricted contract awards is based on such price analysis techniques as:

> (a) Comparison of proposed prices received in response to the solicitation.
>
> (b) Comparison of prior proposed prices and contract prices with current proposed prices for the same or similar end items.
>
> (c) Application of rough yardsticks (such as dollars per pound or per horsepower, or other units) to highlight significant inconsistencies that warrant additional pricing inquiry.
>
> (d) Comparison with competitive published price lists, published market prices of commodities, similar indexes, and discount or rebate arrangements.
>
> (e) Comparison of proposed prices with independent Government cost estimates

FAR, 48 C.F.R. § 15.802-2. These techniques are similar in nature to the estimation of current fair market price in the 8(a) Program which provides that price or cost analysis may be used as well as consideration of "commercial prices for similar products and services, available in-house cost estimates, data...submitted by the SBA or its contractor, and data obtained from any other Government agency." FAR, 48 C.F.R. § 19.806-2(a). For repeat purchases, the contracting officer for 8(a) awards is to consider recent award prices for similar items or work and the comparison of commercial prices. FAR, 48 C.R.R. § 19.906-2(b).

The significant difference between the price reasonableness determination as outlined above for unrestricted contract awards and the price reasonableness determination for set-aside contract awards is the inclusion in the set-aside contract price of the "premium factor" that contracting officers are permitted to consider for any set-aside contract. In other words, a "reasonable price" on a set-aside contract may be higher than a "reasonable price" on an unrestricted contract for identical products or services. The fact that there is no standard or statutory guidance for how much of a "premium" may be considered reasonable leads to the varying interpretations and lack of consistency among agency acquisition personnel that Congress was trying to eliminate by instituting a "fair market price" standard.

SBA should be directed to adopt the "fair market price" standard included in the 1986 Amendments. Such direction will eliminate the continued confusion on this matter, will result in more careful management of federal dollars, and eliminate the need for costly litigation.

SIC Codes

As part of the 1986 Amendments and as part of its efforts to solve the problems associated with the agency practice of "loading" certain industry categories, Congress established a limited program of review of size standards in four industry categories including "refuse systems and related services." Congress required SBA to reduce, if necessary, the current size standard in each listed industry category to a level that would result in 30 percent of the total contract dollars being awarded based on the set-aside programs.

Unfortunately, SBA staff concluded that the industry categories referred to in Section 921(f) had to correspond to SIC codes. SBA in its review of the industry category "refuse systems and related services" only examined the percentage of set-aside awards in SIC code 4953 -- "Refuse Systems." As a result, SBA concluded from the data examined that no more than 22.4 percent of all contract dollars being awarded in the industry category of "refuse systems and related services" was being awarded based on the set-aside programs.

SBA's exclusive use of SIC code 4953 creates two significant problems. First, it ignores the fact that SIC code 4212--"Local Trucking Without Storage" is used to identify firms engaged in "Garbage and refuse, collecting and transporting: without disposal." Indeed, the major difference between the two SIC codes as they relate to "refuse systems and related services" is that SIC code 4953 companies are engaged in either processing or disposing of refuse while SIC code 4212 companies are engaged only in the collection and transportation of refuse. As a result, all contracts for garbage collection not awarded to firms identified as turnkey refuse operations were not considered by SBA in its analysis of the industry category "refuse systems and related services."

By establishing identical size standards, SBA has recognized in the past that SIC code 4953 companies and SIC code 4212 companies engaged in refuse collection should be treated in a similar manner as far as the small business set-aside programs are concerned. The size standard for SIC Code 4953 companies is $6.0 million. The size standard for SIC Code 4212 companies is $12.5 million except for companies engaged in "Garbage and Refuse, Collecting and Transporting: Without Disposal." Footnote 6 to the size standards as published by SBA states:

> SIC-4212: The component "Garbage and Refuse, Collecting and Transporting: Without Disposal" shall have a size standard of $6.0 million. This is the same size standard as SIC-4953, Refuse Systems.

A second problem with the exclusive use of SIC code 4953 is created because of the manner in which SBA collected the data. The SBA data identified contracts awarded to SIC code 4953 companies regardless of whether the contract actually involved "refuse systems and related services." At the same time the data does not include any "refuse systems and related services" contracts awarded to SIC code 4212 companies or any other companies not identified by SIC Code 4953.

The disparity in the data used by SBA is easily shown by examining the Product and Service Code category for "Garbage Collection Services--S205." The data for FY 1986 produced for SBA but not used by SBA indicate that 73 percent of all contract dollars awarded for garbage collection was awarded based on set-aside contracts. This compares with the 22.4 percent figure that SBA concluded was being set aside using the single SIC code 4953. As a result, merely by relying on limited data, SBA was able to change an industry category that is "loaded" with set-aside contracts to an industry category that has only a relatively modest amount of set-aside contracts.

Proposed Changes

Waste Management proposes that the Small Business Administration be directed to implement correctly the fair market pricing standard enacted by Congress in 1986. In addition, Waste Management proposes that the Small Business Act be amended so that goals for total small business concern participation by appropriate industry category in the Government marketplace are established. Waste Management suggests that the goal of 30 percent of the total contract dollars spent in an industry category on contracts above the small purchase threshold can be considered both fair and reasonable.

Such data can be easily collected by use of the Product and Service Codes used by Federal Procurement Data System instead of the SIC codes mandated in the 1986 Amendments. The set-aside programs can then be used in specific areas where small business concerns truly need federal assistance to be competitive and to receive a fair share of federal contract dollars. In those industries where small business concerns are already very competitive, their should be no need for additional federal assistance thereby freeing resources for more critical industry categories.

In order to minimize the immediate impact of such a change, Waste Management recommends that a 3 year pilot program be established for the 4 industry categories already identified by Congress as part of the 1986 Amendments. In particular, a goal of 30 percent small business concern participation in the Product and Service Code S205 should be established. At the conclusion of the 3 year period, Congress can reevaluate the need to modify or expand the scope of the changes.

Conclusion

As indicated above, Waste Management strongly endorses the basic policies of the small business programs. It believes, however, that the set-aside programs should a means of achieving certain goals and should not be a goal in themselves. Both the Government and private industry will benefit if the set-aside programs are used properly as a means of assuring a fair proportion of Government contracts across all industry categories is awarded to small business concerns. The small business concerns will benefit from the experience and financial gain of Government business and the Government will benefit from a healthier economy and industrial base in a broad spectrum of products and services. Waste Management looks forward to working with the Members of the Committee on these important changes.

(Additional material retained in Committee files.)

STATEMENT
BY
THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
TO
THE SUBCOMMITTEE ON GOVERNMENT CONTRACTING AND PAPERWORK REDUCTION
OF
THE SENATE COMMITTEE ON SMALL BUSINESS
ON
SECTION 921 OF PUBLIC LAWS 99-591 AND 99-661,
PERTAINING TO
SMALL BUSINESS SET-ASIDES

AGC is:

- More than 32,500 firms, including 8,000 of America's leading general construction contractors, responsible for the employment of more than 3,500,000 individuals;
- 105 chapters nationwide;
- More than 80% of America's commercial contract construction, including buildings, highways, industrial facilities, and municipal-utilities.

September 21, 1987

The Associated General Contractors of America is in a unique position to comment on Section 921 of Public Laws 99-591 and 99-661, and more generally, on the federal government's small business set-asides. AGC is by far the largest organization to speak for general construction contractors. Construction is by far the largest of the four industries that Section 921 targeted for special review. Over 90% of the general contractors among AGC's 32,500 members are below the small business size standard that the SBA now applies to the construction industry.

AGC believes that Section 921 is landmark legislation. As recently as May of this year, in testimony presented to the House of Representatives' Small Business Subcommittee on Procurement, Innovation and Minority Business Development, AGC repeated the many reasons for its strong opposition to the severe restrictions that the federal government has placed on full and open competition for federal construction contracts:

- Severe restrictions on competition, and the resulting increase in the federal government's procurement costs, are not in federal government's best interest, or the taxpayers' best interest, or even the construction industry's best interest. Especially at this point in the nation's history, whether the federal government should distort the procurement process to achieve social objectives is a question that needs debate. It has never been more important to control government spending.

- The economic characteristics of the construction industry, along with open competition, have long assured an ample opportunity for all competent construction contractors, whatever their size, to succeed. The construction markets that are openly competitive readily accommodate anyone willing to work hard, with determination.

Far from being hostile to small business, AGC is critically dependent upon the success of small business. That is precisely why AGC believes that Section 921 is landmark legislation. AGC encourages the Subcommittee on Government Contracting and Paperwork Reduction to consider the following points:

- Section 921 marks a critical turning point in the long-running debate over the federal government's small business set-asides. The legislation holds the promise that the SBA will soon pour a rational economic foundation for its procurement assistance program. Assuming, for the moment, that the federal government can justify the cost of distorting its procurement procedures, to implement its small business policies, the fact remains that the government's resources are limited, and that some industries are more than willing to release any claim on those resources, because they naturally tend to accommodate small businesses. The SBA could accomplish more, with the same or fewer resources, if it concentrated its resources outside the construction industry -- in short, if it set priorities.

- At the same time, Section 921 is imperfect. The legislation makes no reference, for example, to the secondary mechanisms that the SBA must develop, to be absolutely certain that at least 70% of all federal construction is available for open competition. Lowering the small business size standards for the construction industry will devastate many small construction contractors unless the number and dollar amount of construction contract set-asides fall proportionately.

- To date, the SBA's implementation of Section 921 has left much to be desired. Disregarding the plain language of Section 921(a)(2), the SBA has taken the extreme position that the legislation rigidly locks the agency into using each and every one of the four-digit SIC codes for construction as a separate "industry category." This implies that the agency must establish 26 different size standards, just for construction. The agency's position on this issue is unjustified.

- The agency's commitment to equitable size standards is still questionable. Its analysis of the federal procurement data for the other industries that Section 921 targeted for special review does not meet the highest professional standards. The agency has yet to give any indication that it recognizes or appreciates the need to implement Section 921 uniformly, not only among industries, but also across geographically distinct markets. The agency's suggestion that Congress really intended to refer to "reasonable" prices, when it expressly referred to "fair market" prices, is not credible.

AGC encourages the Subcommittee to monitor the implementation of Section 921, and to consider legislative proposals that go beyond Section 921, to require the SBA to develop secondary mechanisms that will **guarantee** that at least 70% of all federal construction is available for open competition. AGC recommends (1) that SBA focus on the contracting officers within each agency, (2) that it require these officers to rank their contracts according to size, and (3) that it then permit these officers to set aside only the smaller contracts. AGC also recommends that the SBA revise reporting procedures, to give contracting officers no small business "credit" for setting aside construction contracts that exceed 30% of their agency's construction budget.

At the same time, the Subcommittee should strongly encourage the SBA to set priorities. Taking all forms of "small business participation" into account -- through set-asides, subcontracts and competitive awards -- the SBA should proceed to determine the industries that are most difficult for new businesses to enter. Once the agency made that determination, it could then allocate its small business procurement assistance in an economically rational way. The construction industry is clearly one of the easiest for new businesses to enter.

The data that the SBA used to report to Congress on the "advisability and feasibility" of implementing Section 921 reveals that the federal government awarded 95.3% of its construction contracts, accounting for 64.7% of its construction dollars, to small businesses in fiscal year 1985. AGC's long experience and expertise lead it to believe that the complete elimination of all set-asides in the construction industry, and the rational allocation of that procurement assistance to other industries, would have no effect on small business' large share of the federal construction market. Indeed, AGC believes that the long neglect of the differences among the industries that do business with the federal government has been enormously wasteful. Set-asides have accumulated in the industries that are the easiest for new businesses to enter -- precisely where federal involvement is least likely to have a significant or helpful impact. Not even the small businesses that participate in set-asides can afford the tax bill for a federal program that simply encourages water to run downhill.

The SBA's refusal to enforce any priorities has also had the ironic if not perverse effect of choking off the growth of many of the small businesses that its procurement assistance program purports to assist. As even the SBA concedes, federal agencies have restricted competition on an enormous proportion of federal construction contracts. The SBA's own data reveals that federal agencies set aside 77.2% of all of federal construction contracts, exclusively for small business participation, and without regard to Section 8(a) set-asides, in fiscal year 1985. This abuse of small business set-asides devastates the competitive market into which the small construction contractor hopes to grow.

An economically rational allocation of the SBA's procurement assistance program would relieve the construction industry, and a handful of other industries, of the enormous burden that the federal government has unfairly forced than to bear. It would serve everyone's best interest. The proper implementation of Section 921 is a critical first step in the right direction.

ASSOCIATED BUILDERS
AND CONTRACTORS, INC.

STATEMENT OF

ASSOCIATED BUILDERS AND CONTRACTORS

FOR THE RECORD OF THE

SENATE GOVERNMENT CONTRACTING

AND PAPERWORK REDUCTION SUBCOMMITTEE

REGARDING IMPLEMENTATION OF

SECTION 921 OF P.L. 99-661,

THE 1987 DEPARTMENT OF DEFENSE AUTHORIZATION ACT

September 21, 1987

Associated Builders and Contractors (ABC) appreciates the opportunity to comment on implementation by the U.S. Small Business Administration (SBA) of Section 921 of the 1987 Department of Defense Authorization Act (P.L. 99-661)

ABC is a national construction industry trade association representing 20,000 general contractors, subcontractors, and construction industry suppliers. ABC members believe in the Merit Shop construction philosophy — that construction contracts should be awarded in fair and open competition to the lowest, qualified bidder.

Consistent with our overall philosophy, ABC views federal contracts awarded by any criteria other than the lowest responsible bid as inconsistent with government's responsibility to taxpayers to obtain the lowest cost possible in the federal procurement process.

ABC also recognizes the firm commitment of many members of this subcommittee to set-aside programs as a means of fostering small business participation in federal procurement programs. ABC views this commitment as one which intends the use of federal contract set-asides to ensure access for small businesses of all types to a fair proportion of contracts by industry and by federal agency.

In practice, however, such is not the case. During FYs 1984-1986, competition was restricted on more than 64 percent of federal construction contracts through set-aside programs. In certain construction trades, the percentage of contracts "set aside" reaches 91.7 percent. Yet, far fewer federal contracts were "set aside" for small businesses in other industry categories. ABC firmly believes that aggregate government-wide small business set-aside figures don't tell the whole story because too many of those contracts are set aside in a handful of industries and too few contracts are set aside for the remainder of small businesses.

It was in this context of fairness in the federal procurement process that ABC supported passage of Section 921 as originally drafted by the House Armed Services Committee.

ABC believes that too many construction contracts are "set aside" by contracting offices simply because of the nature of our industry. Construction is labor intensive and provides easy entry for individual entrepreneurs. Because the start-up of a construction firm requires relatively small financial and manpower resources, small companies are continually forming in all areas of the nation. Hence, current Small Business Administration size standards classify the vast majority of construction contractors as small businesses -- even those that are large compared with their peers.

In reality, the proliferation and survival of so many small businesses in the highly competitive private construction marketplace is strong evidence that small contractors can adequately compete for and win government contracts, just as they do for private contracts, without government protection. This important point should not be overlooked in any thorough discussion of size standards.

By directing SBA to explore lower construction size standards, Section 921 sought to reduce the number of firms considered likely bidders under the widely used "Rule-of-Two". The goal of Section 921 was to reduce construction set asides to a more reasonable level and force agency procurement officers to make a greater effort to locate potential small business bidders in other categories of federal contracts.

Because there are so many small entrepreneurs in construction, agency procurement officers can always reasonably assume that two or more small businesses might possibly bid on most federal construction contracts. Therefore, as authorized by the "Rule-of-Two" (FAR 19.502.2) which allows a contract to be set aside if two or more small businesses can be expected to bid, agencies can restrict competition on many construction contracts.

After reviewing several categories of size standards as mandated by Section 921, the Small Business Administration did, indeed, recommend lower standards for construction. Unfortunately, they expanded the number of construction size classifications to 26 from 2 in that process without a clear congressional mandate.

The advent of distinct size standards for 26 narrowly defined construction activities could create unprecedented confusion and unfairness in the federal contracting process. The current system of two size standards -- $17 million for general contractors and $ 7 million for specialty subcontractors -- is a clear-cut division that leaves no doubt in the minds of either contracting officers or bidders as to how a contract can be classified for set-aside purposes.

With 26 separate size standards, however, the possibility for administrative confusion is enormous. For example, SBA has proposed individual size standards for "Painting, Paper Hanging and Decorating" contractors ($.50 million) and for "Masonry and Stonework" contractors ($1.50 million). If a federal contract requires the use of decorative (i.e., non-structural) stonework or other interior masonry finishes, this myriad of size standards allows the contracting officer tremendous latitude in his/her decision to classify the contract under either one of these categories.

From the federal agency's viewpoint, this hypothetical contract can be awarded to either one of two (or more) companies of vastly different sizes and capabilities — with no assurance that the agency or officer will not classify the contract to the advantage of the bidder that he/she favors. From the viewpoint of potential bidders, neither decorating nor masonry contractors can clearly and easily understand whether they are eligible to bid on this contract. Twenty-six narrow standards will also allow contracting officers to shift contracts from category to category, and obscure objective analysis of Section 921.

SBA created 26 standards by separating data from each four-digit Standard Industrial Code (SIC) generally applicable to construction. ABC views SBA's interpretation of Section 921 as seriously flawed on this particular point and overreaching in the number of proposed size standards that it has produced. For years, SBA has treated construction size standards from the perspective of two broad categories. Clearly, Section 921 intended that SBA review current size standards, not segregate data to create a host of new categories.

While Section 921 did require SBA to utilize the Standard Industrial Code (SIC) in its analysis, nowhere was SBA's discretion to modify only the current standards limited. Furthermore, since SBA has traditionally operated from the perspective of just two standards, it could reasonably be expected that Congress was requesting analysis of two standards when it passed Section 921. Otherwise, SBA would have been specifically instructed to create new categories. While the two current standards are too high, broad classification leaves little confusion about contract categories. While lower standards would be helpful, 26 new standards are clearly not the answer.

If members of this committee are intent on altering Section 921 in any manner, ABC would first recommend that SBA be expressly confined to utilizing existing construction size standard categories.

S. 1559, introduced by Senator Dixon (D-IL) would alter several portions of Section 921. S.1559 replaces the "fair market price" standard embodied in Section 921 with a "fair and reasonable price " limitation. ABC believes that the term "fair and reasonable" is far too ambiguous. From the standpoint of the construction industry, open competition in the marketplace produces data from which a "fair market price" could be ascertained.

S. 1559 also eliminates the "fair proportion" measure by industry for each agency as now required by Section 921. S.1559 replaces it with a government-wide aggregate measure of "total awards within a Federal Stock Classification." ABC believes that such a measure of participation is improper from the perspective of our industry. Industry-specific, agency-specific data is vital to analyzing the impact reduced size standards have on construction procurement, as well as other industry categories.

ABC, however, does support the provision in S.1559 eliminating the requirement that federal contract awardees perform 50 percent or more of a contract. In today's construction marketplace, a "building team" of as many as 100 specialty contractors can be found on a jobsite, helping the typical general contractor achieve requirements set forth from the owner.

If set asides remain the means by which the federal government encourages small business to bid on federal contracts, ABC urges the subcommittee to consider changes which result in a fairer proportion of set asides by each federal agency to all industries ... including those industries where from the perspective of set-aside proponents, too few contracts are set aside today.

ABC also supports any modification which reduces federal construction contract set-asides to a level from which small construction operators can prove their ability to win federal construction contracts in fair and open competition just as they do every day in the private sector. Small business set-asides should be used as a tool to provide access, not restrict competition, in industries where such help is not needed.

ABC also supports any alternative to Section 921 which allows Congress to adequately assess whether contracts set aside in each federal agency ensure access to federal contracts for small businesses in all industry categories.

The Associated Builders and Contractors stands ready [illegible] assist the subcommittee in improving Section 921 or creating an alternative which reaches the same intended result: fairness and equity for all bidders in the federal procurement process.

AMERICAN CONGRESS ON SURVEYING AND MAPPING
AMERICAN SOCIETY FOR PHOTOGRAMMETRY AND REMOTE SENSING
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Joint Government Affairs Director

STATEMENT

of the American Congress on Surveying and Mapping and
the American Society for Photogrammetry and Remote Sensing
for the Hearing Record of the
Subcommittee on Government Contracting and Paperwork Reduction
Senate Small Business Committee
on
Section 921 of Public Law 99-661

September 21, 1987

The American Congress on Surveying and Mapping (ACSM) and the American Society for Photogrammetry and Remote Sensing (ASPRS) appreciate the opportunity to express our views on Section 921 of Public Law 99-661, the FY 1987 Department of Defense Authorization Act.

ACSM and ASPRS are national professional and technical societies with a combined membership of more than 18,000 individual practitioners. Our members are professionals in surveying and mapping science from industry and private practice, as well as from academic instruction and government service.

The surveying and mapping industry is defined within Section 921 as one of the four industry groups that have been negatively impacted by the excessive number of small business set-asides. The overall purpose of Section 921 reforms is to assure greater participation by all industry groups in small business set-asides to correct the current problem involving the level of set-asides within narrow industry categories.

Industry size standards to define small business and enhance participation are determined by the Small Business Administration (SBA). The standard defining small surveying businesses is $2.5 million in gross annual receipts. Using this standard, 99 percent of our country's surveying firms are considered small business. In theory, size standards are developed to separate the truly small, emerging firms from their bigger, more established and dominant industry competitors. However, for surveying and mapping as well as the other impacted industries defined in Section 921, small business size standards have been set at unrealistically high levels. High size standards, combined with the "Rule of Two" which automatically sets aside contracts if two or more small businesses are willing to compete, has caused excessive set-asides within certain industries.

The ineffectiveness of the small business size standards and set-aside programs was brought to light during hearings by the House Small Business Committee.

Witness after witness told the panel they receive no benefit from the Government's practice of setting aside contracts for small business. Each of these owners of small businesses, ranging from apparel manufacturing to ship repair, dredging, retail oil supply and architecture, said they could not win Federal contracts because the SBA has so generously and imprecisely established size standards in their industries. Rather than competing against their relative peers, they are being shut out of the Federal marketplace by a new class of "big small businesses."

The problem is exemplified by the impact of the size standards and set aside programs on the Nation's surveyors and photogrammetrists. Each of the disciplines within the industry is dominated by small firms, typically one or two professionals with just a handful of technicians and clerical staff.

Surveying firms are defined by SBA as those up to $2.5 million gross annual receipts, despite the fact that the U.S. Census Bureau data shows that no more than 50 of more than 6,000 surveying practices in operation in 1982 fail to fit the definition. In fact, according to the Census figures, a size standard of $100,000 would place 3,784 surveying firms within the definition of small business and 2,295 outside the limit.

Photogrammetrists are in a similar situation. In its 1981 survey of firms in private practice, the American Society for Photogrammetry and Remote Sensing found more than 76 percent had receipts of less than $1 million. SBA defines a small business for the purpose of contracts requiring a helicopter or fixed wing aircraft, which includes photogrammetric contracts, at $6.5 million.

The size standard problem is further compounded by the controversial "rule of two" in the Federal Acquisition Regulations (19.502.2). This combination dramatically increases the number of small business set-asides. It places the largest and truly small firms in the industry between a rock and a hard place while the "big small businesses" benefit exclusively.

The result has been a disproportionate share of government contracts going to a few firms which are not necessarily those which the small business program is intended to benefit.

A review of contracts by the Corps of Engineers shows the incongruity of the set aside program. In fiscal year 1983, through the end of the third quarter of 1984, 344 Corps surveying contracts valued at $151.6 million were set aside for small business, while 15 contracts totaling $2 million were subject to full and open competition.

In Fiscal year 1983, the U.S. Forest Service awarded 235 of 267 boundary survey contracts to small business. These limited competition contracts totaled more than $5 million while the 24 awarded under open competition were less than $500,000.

The Forest Service's record for awarding mapping contracts is no better. During FY'83, only 3 of 23 contracts, valued at $89,000, permitted open competition by firms of all sizes.

In an effort to reduce excessive small business set-asides for the industry, the architect and engineering community requested and successfully obtained a cap on set-asides within the DoD. Military agencies are now subject to an $85,000 cap on set asides for A/E contracts, including those for surveying and mapping services. The provision requires contracts under the threshold to be set aside while those in excess are open to competition by firms of all sizes.

In a report to the House Armed Services Committee, Navy Captain M. M. Dallam, Director of Construction in the office of the Assistant Secretary of Defense, noted that the impact of the cap in fiscal year 1984 was that the number of "set asides decreased slightly but awards to small business firms actually increased." This fact has remained constant in the ensuing years.

The size standard review requirement in Section 921 has resulted in a reduction in the size standard for land surveying and cadastral services from $2.5 million in annual receipts to $250,000 in annual receipts. The surveying size standard reduction should result in some 1,300 land surveying firms graduating from their small business designation. We are pleased that SBA's initial review confirmed that small business set-asides in our industry are disproportionate. However, we are concerned about SBA's methodology used for its size standard review.

The SBA randomly chose to lump together architecture and engineering firms, but separated out surveying and mapping from this group. To be consistent, there should either have been a separate size standard for architecture, engineering and surveying and mapping or these industries should have been viewed together as a group. This was not done. Additionally, mapping was excluded from surveying services because SBA did not consider mapping contracts as professional services. Due to this, mapping contracts were not included in the tally.

Furthermore, the SBA omitted any reference to the "Rule of Two" and the conflict this regulation presents to full implementation of the "fair proportion standard" of Section 921. On the other hand, the SBA report on Implementation of Section 921 does agree to the goal of a "fair proportion" for small business in each SIC to increase the opportunities for small business to participate in a board variety of procurements on an industry-by-industry basis. SBA believes goaling by using a "fair proportion" by SIC code can be achieved. To achieve this goal, however, SBA needs to reconsider the affects of the "Rule of Two."

For many industries, the set aside program has been a built-in disincentive for economic growth. The biggest mistake a surveying or mapping business can make is to grow to the point where it is no longer classified as a small business. In an industry where the Government is a significant client, work will evaporate to nothing once one grows out of the small business size standard. Many firms intentionally stay small, retard growth, and lay-off employees to avoid losing their small business status. This is why the retention of the "fair proportion standard" in Section 921 is critical to proposed solutions of excessive small business set-asides within the impacted industries identified in Section 921.

Amendments to provide for relief from the present small business barrier to growth should be considered by the Senate. Among the possible solutions is: (1) an expansion of the $85,000 cap to all government agencies, (2) a pilot test on the impacted industry groups defined in Section 921, or (3) a limit on the number of set asides in each industry so that a fair proportion of small business participation is spread throughout each industry category. Such proposals would permit firms to grow without divorcing themselves from the Government market.

Large firms would still have ample opportunity to compete for government contracts while the truly small firms would only have to compete against their industry peers for set aside contracts, just as the program was intended.

STATEMENT

Of

HUMPHREY E. FOLK, JR., PRESIDENT

FOLK CONSTRUCTION COMPANY, INC.

MEMPHIS, TENNESSEE

On

SECTION 921

DEPARTMENT OF DEFENSE AUTHORIZATION ACT OF 1987

Before the

SUBCOMMITTEE ON GOVERNMENT CONTRACTING AND PAPER WORK PRODUCTION

SENATE COMMITTEE ON SMALL BUSINESS

HEARING

On

SECTION 921 AMENDMENTS, PUBLIC LAWS 99-591 and 661

STATEMENT
Of
HUMPHREY E. FOLK, JR., PRESIDENT
FOLK CONSTRUCTION COMPANY, INC.
MEMPHIS, TENNESSEE
On
SECTION 921 AMENDMENTS IN P.L. 99-591 and 661

Mr. Chairman and members of the Subcommittee, I am Humphrey E. Folk, Jr., President of Folk Construction Company, Inc., which engages in dredging and rock reventment on the U.S. Inland Waterways. I got into dredging about 8 years ago as part of a channel excavation project on the Tennessee Tombigee Waterway. My company now averages about $9 million in gross annual receipts and qualifies as "small" under the current dredging industry size standard of $9.5 million.

I. Introduction

While Folk Construction is eligible to bid on small business set-aside dredging contracts, and has performed one over the years, I would prefer to see most if not all dredging contracts awarded in unrestricted, rather than restricted, competition. In fact, I think there is little need for set-aside protection except in industries where there is a low level of small business participation overall. In those cases, one way to encourage small firms to enter and become competitive in the government market is to set the size standard low enough to encourage new market entrants. That is why I support reduction of the current $9.5 million dredging size standard. I also believe that small firms will grow and thrive in the open market if most contracts are awarded on an unrestricted basis.

For these reasons, I recently became involved in the efforts of a coalition of the small and larger dredging firms in the industry, the Dredging Industry Size Standards Committee (DISSC). Over the last several years, DISSC has had to petition the Small Business Administration (SBA), the Congress, and finally the courts to seek recognition of the fact that both the dredging size standard and the level of dredging set-asides are too high to promote healthy competition in the industry. The other witness from our group, Mr. William D. Fletcher of Florida Dredge and Dock, has discussed DISSC's past efforts to convince the SBA to lower the dredging size standard, including a recent Court decision which essentially nullified the $13.5 million size standard and reinstated the $9.5 million size standard.[1] Therefore, I would like, instead, to focus my testimony more specifically on the amendments to the Small Business Act which became law last year as part of Section 921 of the Department of Defense Authorization Act of 1987.

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[1] California Dredging Co. et al. v. Sanders, C.A. No. 85-3906 (D.C.D.C. Nov. 3, 1986) ("Memorandum Opinion").

There are a couple of points I would like to stress. As a group we support what may be described as the three goals of Section 921: Equity, Competition, and Market Analysis. We have a few suggestions for implementing Section 921 to achieve those goals. First, we support targets to ensure economically rational distribution of small business contract awards in each industry. We believe the target or goal approach is an important adjunct to determining small business' "fair proportion" based on a particular industry's size standard. Second, we would like to see the vast majority of the contracts in each industry open to competition. Third, the "fair market price" provision of Section 921 is very healthy and should be retained with only slight modification to permit some flexibility in its application. Fourth, we believe an industry's size standard should be set at a level that prevents market dominance by firms that qualify as "small" under that standard.

II. Problems in Set-Aside Program Implementation Prompted the Section 921 Amendments.

As we all know too well, prior to the passage of the Small Business Act amendments in Section 921, the appropriate level of small business government contracting was determined on a government-wide basis. Unfortunately, that method of implementing the Act's "fair proportion" requirement resulted in an inequitable distribution of set-aside procurements among industries. A few industries received a majority of small business and Section 8(a) set-aside procurements, in addition to already high levels of small business participation achieved through unrestricted prime and subcontracts. On the other hand, many industries experienced little or no small business participation. This problem was compounded by unrealistically high size standards which, in turn, often resulted in far more set-aside contracts than contracts open to unrestricted competition.

As a consequence of this lopsided implementation of the set-aside program, there has been no incentive for many firms qualifying as "small" to grow beyond the size standard, leave the protection of the small business set-aside program, and become successful firms in the open market place. The longer that the large "small" firms have stayed in the protected market, the harder and more discouraging it has become for smaller, emerging firms to break into the ranks of the successful Government bidders. In fact, many of the larger "small" firms have become dominant in their fields of operation, particularly in the Great Lakes and Southeast regions. Certain of these dominant "small" firms have tried to prolong their set-aside protection by lobbying for dredging size standard increases ranging from $13.5 million to $21.5 million!

For years the SBA merely studied these problems to death. Then, when it finally acted, it arbitrarily increased the dredging size standard from $9.5 to $13.5 million. That caused the DISSC coalition to join forces with others to find some way to guide the SBA in the right direction.

III. Section 921's Provisions Are Largely Beneficial.

Groups of construction, dredging and other industry representatives supported Section 921 as a workable solution. By mandating that small business receive a "fair proportion" of government contracts in each industry category, the amendments offered small firms at least an equal opportunity to compete for government business--not just in a few industries but in all industries. The concept also promised to adjust the disproportionately high level of set-asides in dredging, construction and a few other industries, and provide for a substantial portion of government contracts to be awarded on an unrestricted basis. In addition, we believed the Section 921 size standard review requirement would result in SBA's analysis of the relevant (geographic and equipment) markets in dredging.

We were pleased that the SBA concluded in its July, 1987 report to the Congress on Section 921 that all but one of the amendments are advisable and feasible.[2] As a group, DISSC would concur with the SBA's general conclusions. We disagree, however, with some specific SBA findings and proposals for implementing Section 921, as discussed below.

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[2] Small Business Administration, Advisability and Feasibility of Implementing Section 921 of Public Laws 99-591 and 99-661, Vol. I at 78 (July 14, 1987). ("SBA's Section 921 Report").

IV. The SBA's Implementation of Section 921 Must Honor the Principles of Competition in the Small Business Act.

As I stated previously, I see Section 921 as having three goals: Equity, Competition and Market Analysis.

I would like to suggest below certain approaches which, with some helpful guidance from the Congress, should help the SBA properly effectuate these goals.

A. Equity:

1. As SBA has suggested, the setting of goals--rather than size standards--is the best method to achieve a "fair proportion" of small business participation in each industry.

Section 921 requires that a "fair proportion" of government contracts be awarded to small business in each industry. This will enable small firms in any industry to enjoy the benefits of the set-aside program and other mechanisms to bring small businesses into the mainstream of government contracting activity. One effective method to ensure fair levels of small business participation in each industry is for the SBA to work with the procuring agencies to establish goals for such participation by industry. The SBA has suggested a somewhat similar approach.[3]

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[3] SBA's Section 921 Report, Vol. I at 38. The SBA suggested analysis of Federal Procurement Data Center statistics for the average and highest levels of small business participation government-wide compared with each agency's record of such participation. Then new goals appropriate for each agency would be set.

2. A Pilot Program Should be Considered to Meet Certain Industries' Small Business Participation Goals.

To implement "fair proportion" goals, a good way to start is with a pilot program. The small business participation goal for certain targetted industries could be a certain percentage point that is consistent with the all-industry average. The targetted industries for the pilot program could be those enumerated in Section 921. So as to test the totality of "small business participation" in each of those industries, small business procurement data should be comprised of minority and non-minority set-aside awards, awards in open competition, small purchases and subcontract awards. Next, "fair proportion" goals could be established for each of these industries by agency. The procuring agency could reach that goal by any procurement method, including open competition, set asides, subcontracting requirements, and small purchases.

A particular help to the dredging industry would be a further effort by the Army Corps of Engineers to award small businesses a fair proportion of Corps contracts in each geographical region of the country. This would restore some balance in our industry which has experienced a disproportionately high level of set-asides in the Southeast, Great Lakes and Inland regions and very little set-aside work in other areas of the country.

We urge Chairman Dixon to consider the "fair proportion" goaling and pilot approach in lieu of the provision in Section 2 of S. 1559 that would return to calculation of the fair proportion goal on a government-wide basis. As to the proposed use of Federal Procurement Data System figures, that approach is acceptable to us as long as the SBA augments those statistics with other relevant data (e.g., Corps of Engineers dredging award data).

B. Competition:

1. A Substantial Number of Contracts Should be Open to Unrestricted Competition.

Various provisions of Section 921 promote the concept that a substantial portion of government contracts should be open to competition on an unrestricted basis. We believe the unrestricted portion should be at least 70%. If this occurs, firms that are successful enough to grow beyond a particular industry's size standard will have ample opportunity to compete for additional government work.

2. The "Fair Market Price" Requirement will Assure That the Government Receives a Fair Price in Both Restricted and Unrestricted Competition.

Section 921 requires that the small business set-aside program apply the same test of "fair market price" that has been used to assess contract prices in the Section 8(a) minority set-aside program. The provision establishes objective criteria by which contracting officers can determine whether both the pricing of and the competition among the competitors has been fair. We do not favor the proposal in S. 1559 and in the SBA's July 14, 1987 report to return to the "fair and reasonable price" language that applied to set-aside awards prior to enactment of Section 921.

Under Section 921, an agency may not award a set-aside contract if the award would result in a cost which exceeds a fair market price. The Federal Acquisition Regulations (FAR), 48 C.F.R. § 19.806-1(a), applicable to the Section 8(a) set-aside program, require the contracting officer to estimate the current fair market price of the required work based on reasonable costs under normal competitive conditions and not on lowest possible costs. Section 19.806-2(a)(2) goes on to say that the contracting officer shall use price or cost analysis and consider commercial prices for similar products and services, available in-house cost estimates, data (including cost or pricing data) submitted by the SBA or its contractors, and data obtained from any other government agency.

The end result should be adoption of a familiar, well-defined standard used in other contracting situations and protection against award of set-aside contracts at unreasonably high costs. The second point is particularly important for award decisions in the dredging industry. Sometimes the Corps receives small business set-aside bid prices that are more than 25% above the Government's estimate of the likely cost of performance. On occasion, the Government estimate has been reassessed in light of the small business bids received, and raised to place the low bidder's price within the 25% competitive range. Since that kind of approach does not result in either a fair market or a reasonable price to the Government, some sort of fair market price provision is necessary.

C. Market analysis:

1. Size Standard Determinations Should be Based on a Market Dominance Analysis.

Section 921 essentially elaborates on principles set forth in the Small Business Act and SBA's size standard policy reports,[4] that size standard determinations must be based on analysis of the competitive nature of the markets in which the industry's small firms operate. These authorities make clear--whether the market is defined by industry group, geographical market, or the capital equipment used--that firms deemed "small" under the industry size standard may not be dominant in the market in which they operate.

The Small Business Act defines "small-business concern" as "one which is independently owned and operated and which is not dominant in its field of operation."[5] When the Congress amended the Act with the provisions of Section 921, it encouraged the SBA to define each industry by use of Standard Industrial Classification (SIC) codes. In addition, Section 921 allowed for definition of markets within a SIC-defined industry. If evidence received by the SBA so warrants, an industry's contract award data can be analyzed either on the basis of "special capital equipment needs", or on a "geographical" basis. A geographical market analysis is appropriate when (1) the government typically designates the area where work is to be performed, (2) Government purchases comprise the major portion of the entire domestic market for the goods or services in question, and (3) due to the fixed location of the facilities, high mobilization costs, or similar economic factors, it is unreasonable to expect significant competition from outside a particular geographic region.

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[4] See, e.g, Small Business Administration, Profile for the Dredging Industry for the Purpose of Setting a Size Standard 9 (June 4, 1984) ("Profile").

[5] 15 U.S.C. § 632.

To avoid any misunderstanding of the intent of Section 921, the amendments's legislative history emphasized how important it is to analyze certain industries on a market by market basis. It acknowledged that the characteristics of the dredging industry warrant more precise market segment analysis of capital equipment needs and geographical region of the industry.[6/]

(a) Capital Equipment

The dredging industry consists of two distinct equipment markets - hopper dredge work and conventional dredging. Approximately 15% to 20% of the dollar value of all federal dredging contracts can be efficiently performed only by large hopper dredges. These dredges are enormous pieces of equipment which cost from $15 million to $25 million to acquire. Due to

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[6/] Statement of Chairman Parren Mitchell, House Committee on Small Business, 132 Cong. Rec. H10140 (daily ed. October 15, 1986).

their high cost, nearly all hopper dredges are owned only by the largest companies in the industry.[7]

The SBA's Section 921 Report dismisses equipment segmentation in one vague, conclusory sentence stating that dredging firms have some degree of flexibility in selecting the type of equipment to use on a project.[8] However, "small" dredging firms can select only the types of equipment they own or can afford to lease. Such firms almost never are capable of "selecting" hopper dredges for a project. While small firms conceivably could use other conventional dredging equipment to perform the same work as a hopper dredge, they would have to operate longer and with less efficiency. As a result, their bid prices might be higher. If the bid price exceeds the Corps' estimate for the job by 25%, the conventional dredge bidder will not be eligible for award. Perhaps this is the reason that the Subcommittee's dredging witness from the Great Lakes region has experienced difficulties in securing hopper contracts.

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[7] In the Corps of Engineers' comments to the SBA for its dredging size standard review, the Corps acknowledged that "[B]ecause dredging is a capital intensive industry, small dredging firms do not possess the capital equipment needed to build or purchase large dredging equipment. With a few exceptions, small dredging firms operate pipeline dredges ... and bucket/clamshell dredges.... No small dredging firms own hopper or dustpan dredges." Letter from Col. George R. Kleb, Corps of Engineers to Monika Harrison, SBA Size Policy Board, June 3, 1987, at 2 ("Corps Comments").

[8] SBA's Section 921 Report, Vol. II at 30.

When hopper dredge contract award statistics are aggregated with all other dredging contract figures, the result understates small business participation in the market for conventional dredging equipment usage. To obtain a clearer picture of competition in the set aside market and the unrestricted market for dredging contracts, the hopper dredge contract dollars should be excluded. If the remaining contract dollar breakdown shows that certain firms qualifying as "small" have received a dominant share, then the size standard should be reduced.

(b) Geographical Markets

Analysis of the dredging industry based on small business participation in each regional market is also warranted. The dredging industry meets all Section 921 criteria for such an analysis, since the government always designates the place of performance and, due to very high mobilization costs and similar economic factors, it is unusual for small dredging firms to compete in geographical markets other than their own.

The SBA itself has acknowledged the existence of regional markets. For example, in its 1984 Profile of the Dredging Industry, the SBA noted that "regional as opposed to national markets have developed and the Corps [of Engineers] tends to set-aside contracts based on the availability of small firms to bid on contracts within each region."[9] The SBA added that dredging is inherently limited to regional operations because the cost of transporting a dredge from one region to another limits the ability to bid successfully outside of a particular region.[10]

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[9] Profile. at 7-8.

The most telling point is that SBA's Profile found at least two of the dredging industry's regional markets (the Inland and Great Lakes regions), "have patterns of dominance suggesting that a lower size standard would be appropriate," since dominant firms in those regions were already defined as "small."[11] Despite this finding, the SBA balked when it faced the need to lower the dredging size standard to prevent dominant firms in certain markets from qualifying any longer as "small". The SBA summarily concluded that market analysis results were "indeterminant", and then arbitrarily increased the size standard!

It was not surprising to me that the Congressional response was to enact Section 921 urging precise market segment analyses where necessary. Nor was I surprised when dredging firms challenged the SBA's action in court. Based on SBA's rulemaking record, including the Profile, Judge Gerhardt Gesell of the United States District Court for the District of Columbia enjoined the SBA's $13.5 million size standard increase,

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10/ Id. at 7-8. The SBA's Profile provided statistics in Table 3 of the Profile's Appendix illustrating the tendency of firms to operate in regional markets. Only a few of the dominant firms in the industry were active in a major way in more than one market.

11/ Id. at 10.

reinstated the $9.5 million size standard and remanded it to the SBA for further review.[12/]

Under the Section 921 amendments and judicial interpretation of other provisions of the Small Business Act, the SBA was required to analyze dredging industry data segmented by equipment and geographical region. The SBA refused to do so, however. In its Section 921 Report, the SBA failed to make any independent judgment, relying solely on comments from the Corps of Engineers.[13/] The Corps indicated merely that it "is not uncommon" for small firms to transport equipment into another region. The Corps did not advise the SBA how often this occurs or which small firms are capable of such long trips. The fact is that only the very largest "small" firms transport equipment, and only occasionally if the contract is large enough to cover the high mobilization costs incurred. Firms large enough to haul equipment great distances to compete in other markets are also large enough to compete in the open market. They do not need the protection of the set aside program.

For these reasons, I believe the SBA should analyze the geographic markets in the dredging industry and should establish one size standard that will be low enough so that no firm

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[12/] In its decision, the Court noted the Profile's conclusion that the dredging industry consists of a series of regional markets, some of which have patterns of dominance suggesting a lower size standard to ensure that dominant firms in those regions do not qualify as "small" firms. Memorandum Opinion at 7.

[13/] SBA 921 Report, Vol. II at 28-30.

qualifying as "small" will be dominant in any significant regional market.

2. The SBA Cannot Use Administrative Burden As a Rationale Against Market Segment Analysis.

As a basis for recommending against segmented size standards for the dredging industry, SBA's major defenses involved administrative burden. The SBA has asserted, first, that the data needed for market segment analysis "is not readily available" and its collection would be "an extremely difficult task."[14] Second, such segment analysis would "add administrative complexity to the size standard regulations."[15] Third, the SBA said that "Administrative precedent of establishing segmented size standards may easily lead to the demand for segmentation in many other industries and therefore, additional complexity in the size standard regulations."[16]

The SBA already has been told once that it acted arbitrarily in failing to make a size standard determination to cure the problem of "small" firm dominance in certain regional markets in the dredging industry:

> The Act does not specify that dominance is to be measured on a national scale and SBA may not limit its inquiry to promulgation of uniform national standards merely for convenience or because this approach may appear

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[14] *Id.* at 30.

[15] *Id.*

[16] *Id.*

> appropriate in the vast majority of cases. When most of the firms in industry are regarded as being confined to a regional market by geographical and financial considerations, the small-business size standard cannot be one that gives a dominant firm in a regional market the preferred status of a small business.[17/] (Emphasis added)

The Congress' enactment of Section 921 also underlined the importance of precise market segment analysis for the dredging industry. Furthermore, to prevent abuse, the Congress strictly limited the circumstances in which market segment analysis would be permissible.

The SBA is on shaky ground arguing administrative burden in the face of these judicial and Congressional mandates. First, collecting the relevant data is not impossible. In the past, the Corps, the General Accounting Office, and even the SBA itself (for its 1984 Profile) have demonstrated the ability to collect complete data on dredging contract awards by Corps districts and regions. Second, the Corps has analyzed dredging data by equipment and region in response to SBA's request for such data. Finally, and most important, the SBA can and should perform precise market segment analyses without necessarily proposing segmented size standards. It seems to me that, if several regions have firms which are "small" yet dominant in their respective regions, there is ample justification for lowering the national dredging size standard. Then, to ensure

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[17/] California Dredging Co. v. Sanders, Memorandum Opinion at 8.

that small business participation does not decrease in other regions, the goaling process can be used to increase participation by small firms where they have been underrepresented.

In sum, I see no reason to repeal the market segment analysis provisions of Section 921, as proposed in S. 1559. Rather, the SBA should be encouraged to honor the will of Congress and the court by reevaluating dredging industry data in the manner we have suggested.

IV. Conclusion

My firm has become successful through hard work, persistence and competitiveness. The small business set aside program has helped us to some extent, and no doubt has helped other firms our size. At some point, however, I think successful firms ought to take off on their own and fight it out in the open market.

The dredging industry will have many new contract opportunities in the next several years. There should be enough work for large, mid-size and small firms alike. To ensure that those opportunities are fairly distributed, I urge the SBA to lower the dredging size standard to encourage the smaller firms to grow into the Corps market. I also hope that the SBA will work with the Corps to set realistic small business goals. As I have suggested the small business portion should comprise all types of set asides, as well as unrestricted prime and subcontract awards. I also urge that a substantial number of dredging contracts will be unrestricted so that firms over the size standard will have plenty of work to pursue.

The Subcommittee is to be commended for giving all interested groups an opportunity to comment on Section 921. Clearly that legislation has provoked a lot of constructive thinking and planning. I believe the major provisions of Section 921 should be retained, and that the Subcommittee should focus on how best to implement them. In particular, I hope the subcommittee will consider a pilot program which, if successful, could be broadened to achieve small business participation goals in all industries.

Thank you.

AAMA
AMERICAN APPAREL MANUFACTURERS ASSOCIATION

January 23, 1987

The Honorable Alan J. Dixon
Committee on Small Business
United States Senate
428A Russell Senate Office Building
Washington, D.C. 20510-6350

Dear Senator Dixon:

On behalf of the Government Contracts Committee of the American Apparel Manufacturers Association, I am pleased to have this opportunity to comment on the amendments to the Small Business Act made by the Defense Acquisition Improvement Act of 1986 (P.L. 99-961). To facilitate your review, we have limited our comments to issues of particular concern to our industry.

Section 921(f) - Review of Size Standards

As you know, P.L. 99-661 proposes to mandate a study of setaside awards in four industries, with mandated reductions in small business size standards in any industry where more than 30% of government contracts have been set aside for exclusive small business participation. Specifically, the SBA Administrator is directed to reduce size standards to the point where the Administrator expects no more than 30% of contracts will be set aside for small businesses.

The scheme set out in P.L. 99-961 is similar to a proposal rejected by the House Small Business Committee last year, H.R. 1178. The AAMA opposed that bill as a wrongheaded attempt at reform. Although the "test case" established by P.L. 99-661 does not extend to the textile and apparel industries, we still think it is a bad idea to seek reductions in setaside awards by reducing size standards. Moreover, we challenge the notion that experience in reducing size standards in the dredging or construction industries offers any meaningful guidance on the likely outcome of applying similar constraints to the apparel industry or any industry other than the industry under review. In short, we believe the concept of the proposed review is ill-advised, and that its use as a "test case" for broader reforms is inappropriate.

When these proposals were before the House last year, we observed that reductions in size standards offer no guarantee that there will be a concomitant reduction in the amount of business set aside for exclusive small business participation. If the SBA Administrator guesses "wrong" in establishing size standards, there may not be enough non-setaside business

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to keep newly "large" contractors in the government market. Indeed, in the apparel industry, where the commercial marketplace is saturated with suppliers, newly large contractors may find themselves out of business altogether. In these circumstances, the only way for a contractor to ensure continued work is to fire enough workers to maintain its status as a "small" business, and that is a prospect that holds little cheer for the apparel industry or its workers.

There may, in fact, be serious problems with size standards in the industries singled out for review under P.L. 99-661. We cannot speak to the problems that may confront those industries, but we can and do disagree with the idea that the way to address problems in the setaside program is to make adjustments in industry size standards. If Congress believes that too much work in a given industry is being set aside for small business, then Congress should address that problem head-on by limiting the number or percentage of contracts that are restricted to small business participation. As clumsy as that process may be, it is not anywhere near as disruptive as tinkering with the size standards.

If too many contracts in a given industry are set aside for small businesses, it is not because there are too many small businesses, but because there are too many setasides. Reducing size standards not only does not guarantee a corresponding reduction in setasides, it does not even guarantee a reduction in the number of small businesses, since some businesses can be expected to discharge employees in order to maintain their status as small businesses. Reductions in size standards only guarantee disruption and uncertainty in the marketplace, and the very real prospect of business failure for companies shut out of the government market. Whatever adjustments in size standards may be appropriate for the dredging industry and the other industries subject to review under P.L. 99-661, we urge the Committee to reject the notion that reductions in the setaside program should be effected by reductions in size standards.

Section 921(a) - Proportion of Contracts Set Aside Determined on Industry Category Basis

The legislation also proposes to amend the small business act to provide that a fair share of government contracts should be set aside for small businesses in each industry category. The intent of this provision is to guard against the proclivity of agencies to load setaside dollars into a few industries while ignoring other industries. We support the concept of this provision, but are uncertain as to the impact of its direction to evaluate spending practices on the basis of four-digit standard industrial classification codes. Many of our members do work that is classified in multiple industrial codes, and a proper evaluation of the government marketplace may not be possible through rigid adherence to the four-digit standard codes. While the statute provides for additional segmentation of the market if warranted, it does not provide for broadening the market definition by taking into account several SIC codes. We suggest that such flexibility would provide a more accurate account of the government marketplace in industries, such as the apparel and sewn products industry, where companies cannot fairly be classified in one SIC code alone.

Section 921(c) - Assurance as to Composition of Labor Force

The legislation includes a restriction on subcontracting that would prohibit small business contractors from subcontracting more than 50% of the cost of a contract. The legislation properly excludes the cost of materials from this calculation, since materials often account for the greater part of the contract price. We note that the legislation also provides that the Administrator of the SBA may adjust this figure -- up or down -- to account for conventional industry practices. The ability of the Administrator to adjust the percentage of permissible subcontracting is an important consideration for several of our members who subcontract work to other small businesses. However, regardless of the percentage permitted for subcontracting, we suggest that small business setasides should be subcontracted only to other small businesses.

Section 921(b) - Awarding of Contracts at Fair Market Prices

Finally, the Act would require that setaside contracts be awarded only at fair market prices. We support this change in the law.

We very much appreciate this opportunity to comment on P.L. 99-661, and commend you, Senator Weicker, and Senator Bumpers for your leadership in undertaking this review. If we can provide you with additional information, or otherwise assist you in any way, please do not hesitate to let us know.

Sincerely,

Jeffrey J. Weinsten
Chairman, Government Contracts
Committee

AMERICAN APPAREL MANUFACTURERS ASSOCIATION

October 8, 1987

Hon. Alan Dixon, Chairman
Subcommittee on Government Contracting
  and Paperwork Reduction
Committee on Small Business
United States Senate
428A Russell Senate Office Building
Washington, DC 20510

Dear Mr. Chairman:

The American Apparel Manufacturers Association supports your decision to review and amend the provisions of the 1986 Department of Defense authorization act that recommended numerous changes in the administration of the small business setaside program. As you know, most military apparel is made under the small business setaside program. Our purpose in writing is to reiterate our concerns regarding two issues that were incorporated in the revisions to the setaside program. We first raised these concerns in correspondence with your office earlier this year. A copy of that letter is enclosed.

As you know, the act recommended reductions in size standards in selected industries where more than 30% of Federal contracts were set aside for small business. The textile and apparel industries were not included among the industries singled out for review. Indeed, they were expressly excluded from that review. Nonetheless, we strongly object to any notion that the way to achieve reductions in small business setasides is to reduce size standards. Such an approach to this problem is, at best, excessively clumsy -- and rife with opportunities for disaster. For this reason, we support your decision to delay implementation of the proposed changes in industry size standards.

In January, the Small Business Administration noted that "it will be impossible to select a 'magic' number [to] ensure that setasides hover at or around 30% of total procurement dollars in the SIC." (Letter from Monika Edwards, Associate Administrator for Procurement Assistance, to Senator Alan Dixon, January 9, 1987) The SBA's July 14 report to the Congress on the "advisability and feasability" of implementing Section 921 of Public Laws 99-591 and 99-661 again noted that "one of the weaknesses cited for the methods used to develop revised size standards was the uncertainty of the effectiveness of the lower standards to reduce the level of set-aside and 8(a) contracts." These concerns were emphasized in recent testimony before your committee by Ms. Edwards.

We share that concern. As we have noted in our previous statements, there can be no guarantee that reductions in size standards will result in a corresponding decrease in setasides. The only guarantee is that certain firms that now compete as small business will be shut out of the small business

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setaside program. In our industry, where commercial markets are saturated and the vast majority of government contracts are awarded under the setaside program, the small government contractor that cannot compete for setaside awards runs the serious risk of going out of business.

The fact of the matter is that there is no reason to put small businesses in such jeopardy. If Congress believes that there should be a reduction in the number of small business setasides, it can set a cap on setaside awards, as the SBA has suggested. A cap would reduce the number of setaside awards without denying contracting opportunities to the small businesses that have historically served as the backbone of the defense industrial base. If there are too many setasides (a conclusion we are unwilling to accept at face value), then it seems appropriate for Congress to address this issue head-on, rather than employ such indirect methods as the proposal laid out in the DOD authorization bill.

We are pleased to see that you plan further review of this question, and look forward to the opportunity to participate in that debate.

Another issue merits comment. The DOD authorization act proposed constraints on subcontracting under the setaside program, limiting subcontracts to no more than 50% of the value of the contract. In response to concerns voiced by this organization and others, the cost of materials was exempted from this calculation, since such costs frequently make up a significant part of the value of a contract or subcontract. We note that you have now proposed (and the Senate has passed an amendment) to require only that a contractor exercise its best efforts to limit subcontracting under a small business setaside contract. We have no quarrel with this proposal, provided that it is understood that the cost of materials cannot fairly be considered in these calculations -- and with the additional understanding that there is nothing improper in subcontracting work to other small contractors. We understand that this effort is intended to preserve the integrity of the small business setaside program by preventing contractors from subcontracting the bulk of a contract to a big business. No harm is done to the setaside program, however, if a contract provides subcontracting opportunities for small companies. We believe that your proposal is sensitive to this important issue.

We appreciate this opportunity to present our views, and applaud your leadership in addressing the many questions that concern the future of the setaside program. We would appreciate the inclusion of this letter in the record of your recent hearings.

Sincerely yours,

G. Stewart Boswell
President

GSB/jat
Enclosure
cc: Ms. Christine Lundregan, Senator Alan Dixon
Mr. Bill Montalto, Committee on Small Business
Mr. Dirk Forrester, Congressman Jim Cooper
Mr. Hal DeCell, Congressman Jamie Whitten
Mr. Jack Hoggard, Senator Thad Cochran

ADDITIONAL MATERIAL

VOLUME I

ADVISABILITY AND FEASIBILITY OF IMPLEMENTING SECTION 921 of PUBLIC LAWS 99-591 and 99-661

Prepared for:

Committee on Armed Forces
and the Committee on Small Business
U. S. House of Representatives
Washington, D.C.

and

Committee on Armed Services
and the Committee on Small Business
U.S. Senate
Washington, D.C.

Prepared by:

U.S. Small Business Administration
Office of Procurement Assistance
Office of Procurement Policy and Liaison
Washington, D.C. 20416

July 14, 1987

EXECUTIVE SUMMARY

Public Laws 99-591 and 99-661 required SBA to conduct this study on the "advisability and feasibility" of implementing the amendments to the Small Business Act. To evaluate effectively the impact of the amendments on SBA programs, SBA conducted and carried out a number of research efforts: (1) an extensive review of related literature, (2) a structured interview survey, (3) several questionnaire surveys, (4) analysis of data from the Federal Procurement Data Center and the United States Establishment and Enterprise Microdata file, (5) interviews with procurement policy personnel of major agencies, (6) discussions with representatives of major industry associations and, (7) solicitation of public comment.

The principal amendments of P.L. 99-661 which must be implemented and that are expected to have an impact on the Small Business Administration programs are:

1. Neither small business set-asides nor "8(a)" contracts may be awarded above the "fair market price";

2. Recipients of small business set-asides or "8(a)" contracts for services must perform at least 50 percent of the cost of the contract with their own employees, 50 percent of non-material costs in the case of manufacturing, and an amount to be determined by SBA in the case of construction or any other industry not covered by the statute;

3. The annual goals of each procuring agency, established under section 15(g) of the Small Business Act, will be premised upon all awards, rather than upon those above $10,000;

4. The objective of achieving a fair proportion of Government contracts for small business is now directed at each Standard Industrial Classification (SIC) code industry, rather than at the totality of Government procurement, as previously held;

5. Size standards for small business eligibility will be based on SIC industries, by law;

6. Contracting officers will be required, upon request, to provide a list of expected small business offerors when a small business set-aside is made; and

7. Size standards in the industries of construction, architectural and engineering services, shipbuilding and repair, and refuse systems and related services are to be adjusted to assure that small business set-asides and "8(a)" contracts do not account for more than 30 percent of awards in each industry.

Fair Market Price

Legislative history indicates that the purpose of the statutory standard of "fair market price" was to provide a more precise definition of when a set-aside offer may be accepted.

Small business set-aside price reasonability is covered thoroughly in FAR 14.407-2 and 15.802 in the same manner as unrestricted procurement. Additionally, the full discussion of "fair market price" for 8(a) now in FAR approximates the referenced regulations for establishing a "reasonable" price.

SBA believes, therefore, that the references to "fair market price" should be considered synomynous with "reasonable price" and that the existing FAR standards for determining a "reasonable" price should be applied both to 8(a) and set-asides.

"50% Rule"

The "50% rule" limitation on subcontracting imposed by this new statutory provision on the set-aside program is intended to prevent system abuses, although the restriction may be detrimental to some small businesses, which often lack the in-house capabilities that large businesses have. From the study results, however, it would appear that the subcontracting limitation provision would not have an adverse effect on most of the reviewed industries.

While there was public comment on the "50% rule" as a result of the Federal Register announcement, no concrete data were presented which would justify modification of the rule. Additionally, preparation of a model and limited experiments with it supported the tentative view that the rule could be applied consistently. The principal problem with the rule is the administrative difficulty of enforcement. That difficulty would be eased by permitting the application of measurement to the value of the contract in question rather than to "costs" which are more subject to variable accounting methods.

Goaling

Since implementing goal-setting in 1980, there has been only a small increase in the annual share of federal contract dollars going to the four targeted groups examined. Although there has been a significant increase from FY 80 of 17 percent to 20 percent in FY 86, in the small business share (Table 4.2), the increase between years has been relatively small. Therefore, the data tends to support the public argument that goaling had only a small impact on increasing the small and small disadvantaged business share of the total federal contract budget.

Even a small impact, however, means a significant increase in the dollars going to small business. Additionally, the overall value of "goaling" as a means of focusing attention of procurement personnel on small business participation was supported by procurement policy personnel of some major agencies. SBA, therefore, supports the continued use of "goaling."

SBA believes that goaling enhances small and small disadvantaged business participation in Federal contracts. In order to make goaling meaningful in terms of the requirements, SBA propose a consistent structure for the agency attempts to expand participation by industry category.

SBA suggests that Federal Procurement Data Center (FPDC) data be obtained by agencies, establishing on a government-wide basis the level of participation by small and small disadvantaged business in each of the most significant SICs, i.e., those in which the major portions of dollar value are being awarded. SBA would identity these annually from FPDC data. Agencies would also obtain from FPDC a record for the major SICs. This will permit each agency to address a manageable span of issues by establishing the reasons for their variance and identifying means to enhance participation where it is possible.

"Fair Proportion" by SIC

The goal of a "fair proportion" for small business in each SIC is intended to increase the opportunities for small business to participate in a broader variety of procurements on an industry-by industry basis, rather than limiting their participation to a few industries where small business has historically received a large share.

On balance, SBA considers that goaling will focus attention on those SICs in which small and small disadvantaged business is now at minimal levels.

SIC System for Establishing Size Standards

Although there are many known defects in the SIC system, it still remains the most popular delineator of economic markets. SBA has used it in the past by administrative choice, and has no objection to continued use. However, some industries exist or come into being which do not fit the SIC structure, the flaws of which are noted in this report, SBA may be unable to deal directly with the problem because of the restriction by the law to the SIC system.

Listing of Candidate Firms for Set-Asides

While the increase of opportunity to identity violations of small business certification is a beneficent purpose, SBA believes that the increased burdens on contracting personnel would, on balance, detract from the use of set-asides, to the overall detriment of the general community of small businesses interested in Government business.

"30% Rule"

The amendments address two features of the set-aside and 8(a) programs--the level of set-asides and the definition of eligible small businesses. These features focus policy debate on questions of how much contract funding to devote to support these programs and who will be the potential beneficiaries of the programs.

The amendments attempt to answer the question of the level of contract funding by controlling who may participate in the programs. In the report, one of the weaknesses cited for the methods used to develop revised size standards was the uncertainty of the effectiveness of the lower standards to reduce the level of set-aside and 8(a) contracts. A more effective policy to lower set-asides and 8(a) contracts may be to set a cap on these awards on a Federal-wide or Agency-wide basis. It may also be a more efficient way to achieve lower set-asides and 8(a) contracts.

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Section 4

"ADVISABILITY AND FEASIBILITY" OF IMPLEMENTING SECTION 921 OF P.L. 99-661

The principal amendments which must be implemented and that are expected to have an impact on the Small Business Administration programs are:

1. Neither small business set-asides nor "8(a)" contracts may be awarded above the "fair market price";

2. Recipients of small business set-asides or "8(a)" contracts for services must perform at least 50 percent of the cost of the contract with their own employees, 50 percent of non-material costs in the case of manufacturing, and an amount to be determined by SBA in the case of construction or any other industry not covered by the statute;

3. The annual goals of each procuring agency, established under section 15(g) of the Small Business Act, will be premised upon all awards, rather than upon those above $10,000;

4. The objective of achieving a fair proportion of Government contracts for small business is now directed at each Standard Industrial Classification (SIC) code industry, rather than at the totality of Government procurement, as previously held;

5. Size standards for small business eligibility will be based on SIC industries, by law; and

6. Contracting officers will be required, upon request, to provide a list of expected small business offerors when a small business set-aside is made.

7. Size standards in the industries of construction, architectural and engineering services, shipbuilding and repair, and refuse systems and related services are to be adjusted to assure that small business set-asides and "8(a)" contracts do not account for more than 30 percent of awards in each industry.

A discussion of provisions 1 thru 6 is provided below. The "advisability and feasibility" of implementing these amendments made by Congress to the Small Business Act, and whether or not these amendments will further the interest of the small business set-aside program, will be discussed in detail, numbered to correspond with the listed provisions above.

A discussion of the SBA Size Standard Staff's review of the "30% rule" will be presented in Volume II of this report

1. A Contract May Not Be Awarded Under This Subsection (15.a) If The Award Of The Contract Would Result In A Cost To The Awarding Agency Which Exceeds A Fair Market Price.

The standard for awarding set-aside contracts is currently "reasonable price". The term "fair market price" has been the standard used for awarding 8(a) contracts. However, the term "reasonable price" was the previous standard used for awarding set-aside contracts.

First, before we discuss the impact of this provision on the Small Business Administration programs, it is important to examine the components of market price and how a market price is derived. Therefore, a complete discussion on this issue is presented in Appendix A.

A market price is defined as a current price, established in the usual and ordinary course of trade between buyers and sellers free to bargain, which can be sustained from sources independent of the manufacturer or vendor, although the obtaining of such pricing data may have to come from the seller.[5]

Competition has long been recognized as the best method to obtain fair and reasonable prices. In 1809, Congress passed a law requiring competition in contracting and stipulated that "all purchases"...shall be made either by open purchases or by previous advertising for proposals. This preference was reaffirmed in 1861 when Congress enacted a law requiring advertising for purchases, unless "public exigency" was involved.[6]

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[5] Calvin Bursman, "Subcontracting Made Easy: A Fair and Reasonable Price-The Name of the Game," Contract Management (September 1984), p. 26.

[6] Callahan, Op. Cit., p. 71.

Although these efforts and those that came after were laudable, they did not provide the needed impetus to increase competition. In fact, statistics showed that almost two-thirds of government acquisitions were being made on a noncompetitive basis. Many reasons were given for the high percentage of noncompetitive acquisition, including insufficient time and effort committed to maintaining competitive sources of supplies and advance planning, dependence on the incumbent contractor's product/service, institutional bias toward in-house solutions, lack of skilled personnel and unwillingness to change current practices, inability to clearly define mission requirements, exaggeration of the value of short-term expediencies, and rewarding performance based on factors other than reducing cost. [7]
Congress apparently felt that these factors were undermining competitiveness and that the federal bureaucracy was either unwilling or unable to solve the problem. The result was the passage of the Deficit Reduction Act of 1984, Title VII of which became known as the Competition in Contracting Act (CICA).

In enacting the CICA, Congress sought to require that, "executive agencies", except under limited and well defined circumstances, use full and open competition in making contracts to acquire property or services. Full and open competition is accomplished only when (1) all qualified vendors are allowed and encouraged to submit offers on federal procurement, and (2) a sufficient number of offers is received to ensure that the government requirements are filled at the lowest possible cost".[8]

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[7] IBID.

[8] U.S. House of Representatives, 98-1157, "Competition in contracting Act of 1984," (October 1984), p.17.

Acknowledging that there were valid circumstances under which full and open competition could not be achieved, the CICA recognized both limited competition and noncompetitive procurements. The net result is a dual system consisting of competitive and other-than-competitive procedures. The significant precept, however, remains competition and the use of other-than-competitive procedures is restricted.

Although competition may be restricted to fulfill statutory requirements relating to small business concerns, these procedures are still considered to fulfill the requirement at CICA for full and open competition. Likewise, particular sources may be excluded to establish or maintain an alternative source or sources of supply, to increase or maintain competition, or in the interest of national defense.

Included in the competitive proposal category is the combination of competitive procedures formerly known as Two-Step Formal Advertising. In this procedure a submission, evaluation, and discussion of a technical proposal is followed by the submission of sealed bids.

Other contracting techniques, specifically identified in the CICA as acceptable competitive procedures, are: (1) procurement of architectural or engineering services; (2) the competitive selection of basic research proposals resulting from a general solicitation and the peer review or scientific review (as appropriate) of such proposals; and (3) the procedures established by the Administrator, for the multiple awards schedule program of Government Service Administration.[9]

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[9] IBID.

The "other-than-competitive procedures" outlined in the CICA recognizes that at times it may not be in the Government's best interest to use competitive procedures. The number of circumstances under which noncompetitive procedures are permitted have been reduced to seven under the CICA: (1) when the need is of such an unusual and compelling urgency that the government would be seriously injured; (2) where the product or services are available from only one responsible source; (3) to maintain a source in the event of a national emergency or to achieve industrial mobilization;(4) as required by international agreement; (5) where required by statute; (6) for national security purposes; or, (7) when an agency head determines it is in the public interest.[10]

Impact of "Fair Market Price" on SBA Programs

Analysis of the Structured Interview Survey. The six people who participated in this interview were asked what they thought fair market price meant. They were given the following choices and asked to choose the appropriate choice or choices: (1) reasonable price, (2) lowest price, (3) competitive price, and (4) combination of the above.

Four of the interviewees stated that they thought that fair market price was the lowest price and two stated that they thought it was a competitive price. They were also asked how they thought contract personnel could interpret "fair market price". The interviewees responded as follows: five said lowest price and one said a combination of competitive and lowest price.

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[10] IBID.

From the responses given, it is clear that most of the interviewees had a diverse opinion of "fair market price". Their responses also indicated that they thought contracting officers would interpret "market price" as the lowest price most of the time.

Analysis of the Questionnaire Survey. A total of 33 PCRs participated in this survey. Each PCR was asked what they thought "market price" meant. From the results of the survey, there seems to be considerable disagreement among the PCRs as to what "market price" means. Forty-nine percent of the respondents agreed that "market price" meant competitive price, while thirty-seven thought it was a combination of the following prices: reasonable price, catalog price, lowest price, and competitive price. The PCRs were also asked how they expected contract personnel to interpret "Fair Market Price". A majority of their responses are presented below:

- After some confusing uncertainties, I anticipate that management will direct buyers to consider "Fair Market" price and "Fair and Reasonable" price to be synonymous
- Usually the only information available that can be used to determine fair pricing is previous prices and current offers. The CO's conclusions will be the same whether it's called "fair market" or "fair and reasonable"
- Competitive price including large business bids
- Base it on adequate competition
- "Lowest price" for small business bidders
- That will depend on the government technical user personnel demands and priorities plus "on whatever the traffic will bear"
- Lowest price
- Catalog prices, procurement history, government estimate
- Lowest possible price

- Previous bid price plus 10%
- A price for which an item/service may be purchased on the open market
- Low bid or offeror
- In line with the lowest award price previously made or the COs will want to test the market through unrestricted competition to determine current "fair market price"
- If procured before-check abstract of bids/offers versus the government estimate, if not procured before, buyer could get "estimates" of price from prospective bidders/offerors

In addition, the PCRs were asked if they thought the "fair market price" rule would have a negative effect on competition among small business. Forty-eight percent of the respondents felt that the "fair market price" rule would have a negative effect on competition among small business, while only 9 percent felt that it would have a positive effect on competition, and 42 percent felt that it would have no effect.

The PCRs were also asked a question concerning the interpretation of the "fair market price" rule. They were asked if the legislation should be interpreted to reflect that "a contracting officer can't reject a set-aside bid merely because some larger firm may be able to offer a "lower price." An overwhelming 87 percent of the respondents felt that the legislation should be interpreted to reflect the above issue, whereas, only 14 percent felt that it should not be. The PCRs also argued that the contracting officers should remove the set-aside awards from the market once a large company submits a bid on them. The PCRs suggested that large business would offer token bids to break up set-asides. Therefore, the contracting officers should not rely only on large business bids to establish a "fair market price", but should be required to do independent price analysis to establish a "fair market price."

Comparison of Pricing Standard

Legislative history indicates that the purpose of the statutory standard of "fair market price" was to provide a more precise definition of when a set-aside offer may be accepted. This would ensure uniformity in the assessment by contracting officers of acceptability of set-aside offers. The criteria of "fair market price" were already established in FAR 19.806-2 which cited specific points for estimating a fair market price for an 8(a) contract: recent award prices for the same product or service; assuring the requirements are comparable; price indices to determine charges in labor or material costs; and commercial prices for similar items.

Contracts awarded under unrestricted conditions are also required by FAR 14.407-2 (sealed bids) and 15.802 (negotiation) to be awarded at "reasonable" prices. For negotiated contracts, of course, extensive guidance is provided in FAR in order to establish a "fair and reasonable price": price analysis; technical analysis; and, cost analysis, based on data required from the contractor. "Price analysis" alone addresses: comparison of proposed prices; comparison of prior prices; application of established "rules-of-thumb"; comparison of published price lists or indices; and comparison to government estimates. It is also pertinent that the requirement for reasonable price awards in the case of sealed bids cites "price analysis", as discussed in FAR 15.805-2, as guidelines for determining reasonability.

Small business set-aside price reasonability is covered thoroughly in FAR 14.407-2 and 15.802 in the same manner as unrestricted procurement. Also, small business set-asides are, by definition, considered competitive solicitations, an important distinction from 8(a) contracts which are awarded on a sole-source basis. While it is true that set-aside offers may only be accepted if the price is reasonable, that is also true under FAR for any other offer.

Special language is appropriate for the 8(a) program, which is sufficiently limited in volume and narrow in purpose to permit special attention. The set-aside program however, has been directed toward consistency with standard procurement practice, with the distinction being only the narrow difference of limited source solicitation. As indicated in the surveys of SBA field personnel, the stressing of slightly different criteria for the reasonability of price may result in confusion and, therefore, a de-emphasis on the use of set-asides. This is especially the case where a new requirement is established by law, and the normal economic interpretation of the terms suggests limitations which we do not believe Congress intended. Additionally, the full discussion of "fair market price" for 8(a) now in FAR approximates the referenced regulations for establishing a "reasonable" price.

SBA believes, therefore, that the references to "fair market price" should be construed as synonymous with "reasonable price" repealed and that the existing FAR standards are sufficiently clear to govern both 8(a) and set-aside awards.

2. The Legislation States That Recipients Of Small Business Set-Aside Or "8(a)" Contracts For Services (Except Construction) Or Supplies Must Perform At Least 50 Percent Of The Cost Of The Contract (Not Including The Cost Of Materials In Manufacturing Contracts) With Its Own Employees.

In a 1984 decision by the Small Business Administration, the Office of Hearings and Appeals emphasized the need concerning small business set-asides to exercise care in dealing with large business subcontractors.[11] SBA is concerned with small business being used to front for large business in the implementation of the small business set-aside program, which is intended to insure that a "fair proportion" of government procurement is awarded to small business. If SBA perceives that a large business subcontractor is able to control a small business prime, the small concern will not be allowed to reap the benefits of the small business set-aside program.

Although there is nothing in the Small Business Act which precludes a small business from subcontracting with a large business on a set-aside requirement, small business contractors should be concerned about subcontracting circumstances which might lead to a determination that a joint venture exists, resulting in a finding of affiliation between the small and large concern. Such a finding would render the otherwise small business prime contractor ineligible for award of a set-aside contract if timely protested.

In a memorandum prepared for SBA on subcontracting and small business status, several issues concerning subcontracting percentages were addressed. A joint venture was found based on the following percentages: "94.3 percent (Size Appeal of McDaniel and Burroughs, Inc., No. 1187, July, 1978); 90 percent (Size Appeal of Lester B Holmes Co., No. 569, July 19, 1972); 75.2 percent (Size Appeal of A&S Air Conditioning, No 1172, May 17, 1978); 64.5

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[11] U.S. Small Business Administration, Office of Hearings and Appeals, "In the matter of Integrated Systems Analysts Inc., Appeal No. 1923", (April 11, 1984), Washington, D.C., p. 1.

percent (Size Appeal of Dyn Logistics Services, Inc. and Alpak Container Corp., No. 2084, November 28, 1984); 54 percent (Size Appeal of Information Management Services, Inc., No. 1766, August 3, 1983); and 48 percent (Size Appeal of Integrated Systems Analysts, Inc., No. 1923, April 11, 1984)".[12]

The percentage of work subcontracted, if considered alone, is not sufficient to establish the ability of the subcontractor to control the prime contract; and the total performance of the contract must be evaluated (Size Appeal of Swepco Corp., No. 1449, June 8, 1981).

In the Swepco Corp case, one subcontractor was performing 54 percent of the total value of the contract. The Size Appeals Board held that there was no joint venture because: (1) the prime contractor (small business) was actively engaged in the performance of the contract; and (2) the prime contractor (small business) was exercising an overall supervisory role.

In "Size Appeal of Watson Planning, Inc., No. 1777, there was no unusual reliance where a small business performed only 6 percent of the contract value and subcontracted functions constituting 61 percent (asphalt supply) and 17 percent (asphalt laying) of the contract value to one large business".[13] The decision was based on the following:

> (1) the small business did have some expertise in the paving industry; (2) the small business would perform on site tasks on the contract, in addition to supervision; (3) the small business was not financially dependent on the subcontractor; and (4) no other factors existed which would compromise the small businesses' ability to supervise and control the performance of the contract.

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[12] John W. Klein, Memorandum on Subcontracting Percentage, Prepared for Martin Teckler - Deputy General Counsel, U.S. Small Business Administration (March 19, 1985).

[13] IBID.

Subcontractors that supply materials may be distinguished from subcontractors that perform work. In Size Appeal of Delta Construction Company, "the small business prime contractor needed asphalt from a large subcontractor, the cost of which was approximately 50 percent of the cost of the total project. In holding that there was no affiliation based on a joint venture, the Office of Hearing and Appeals relied on the fact that the large subcontractor was scheduled to perform a mere 3 percent of the contract price minus the cost of the asphalt."[14]

While SBA looks closely at the percentage of work to be performed by a large business under a small business set-aside, other factors may also contribute to the "unusual reliance" by the small business upon the large. Lambert and Shillito[15] discussed several of these factors that contribute to the "usual reliance". A discussion of these factors is given below:

(1) Role of the large business subcontractor in proposal preparation. If the large business subcontractor actually prepares the bid proposal or a significant portion thereof and interfaces with the government, it is likely to be concluded that this is indicative of the large concern's ability to control the small concern, resulting in a finding of affiliation [In the Matter of Integrated Systems Analysts (ISA) Inc., Appeal no. 1923, April 11, 1984].

(2) Large business subcontractors providing financial, management, or technical assistance to the small business prime contractor. Even without the large concern serving as a subcontractor, it is likely to be concluded that

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[14] IBID.

[15] David Lambert and Barry Shillito, "Problems in Subcontracting Under a Small Business Set-Aside," Contract Management (1984), pp. 15-19.

with this kind of assistance the companies are affiliated. If a large concern is providing financial, management or technical assistance and also serving as a subcontractor, there is an even greater likelihood that affiliation exists (Metric System Corp., 1980).

(3) Large business subcontractor in a management position under the contract. In the ISA decision (1984), the contractor was required to perform six general distinct tasks as follows:

Task 1 - acquisition planning support,
Task 2 - ship production management,
Task 3 - technical documentation,
Task 4 - logistics management support,
Task 5 - engineering services, and
Task 6 - ship program status report.

Each of the six tasks had a task manager who was responsible for assigning people and resources to their particular area of responsibility. SBA found that although ISA's program manager provided supervision over the task managers, Adtech's (Advanced Technology Inc., a recognized large business that ISA intended to subcontract to) task managers supervised 71 percent of the key management personnel for the total contract. Consequently, SBA found that ISA had "usual reliance" on Adtech to supply the key management personnel for the requirement.

(4) Clear delineation of services to be provided between prime and subcontractors. The services to be performed by a large business subcontractor should be both limited and specified (Cadcom, 1977). In most instances SBA is able to distinguish between what the small business prime is doing versus what the large business subcontractor is doing. In those instances, where there is not a clear delineation of responsibilities, SBA is inclined to find "unusual reliance" by the small business prime contractor upon the large concern, resulting in affiliation (Human Sciences Research Inc., 1982).

Moreover, a small business should take precautions to prevent the appearance as well as actual control by a large business when bidding on a small business set-aside. If a small business is not careful in structuring its relationship with a large business subcontractor, it may unwittingly be denied the fruits of the small business set-aside program.

Possible Negative Effects of the "50 Percent Rule"

The "50% rule" limitation on subcontracting imposed by this new statutory provision on the set-aside program is intended to prevent system abuses, but the restriction may be detrimental to some small businesses, which often lack the in-house capabilities that large businesses have. To illustrate some of these negative effects, the Architecture and Engineering Services industry will be used as an example. In his comments submitted to the Size Policy Board in response to the March 17, 1987 Federal Register notice on these amendments, James Folk, who represented Coffey, McGovern and Noel, LTD urged SBA to lower the 50% subcontracting limitations to reflect the coventional practices of small businesses in the engineering industry. He further stated that:

> "This firm represents several businesses, both large and small, that are prime or subcontractors providing engineering services to government agencies. We frequently advise clients regarding subcontracting relationships under small business set-asides, and have had the opportunity to observe first-hand the industry customs and usages under the engineering SIC Codes.
>
> Engineering services procurements usually require the small business contractor to provide a variety of specially qualified employees to perform a complex series of tasks. Almost all small business subcontractors are forced to subcontract a substantial portion, even a majority, of their engineering work. This subcontracting is not inconsistent with the goals of the small business set-aside program. Small businesses receive the experience and increasing revenue.
>
> Moreover, the 50 percent limitation on subcontracting will actually pervert the purposes of the small business set-aside program. Only the largest small businesses will be able to perform engineering contracts in compliance with the subcontracting limitation. The less established or fledgling small businesses, who need the most assistance, will not be able to perform the engineering contracts as prime contractors. In addition, fewer subcontracts will be available for small businesses to perform if the 50 percent subcontracting limitation is in effect.[16]

Analysis of the Structured Interview Survey Pertaining to the "50 Percent Rule"

It was the general consensus of all the interviewees that large firms obtained a considerable amount of set-aside awards through collusive arrangements with small firms and then performed substantially all of the work as subcontractors. In some instances, it was said that the small firm is often a nominee, sometimes a former employee, of the large company.

Dr. Chandler, a professor at Howard University, stated that in some instances in the dredging industry, the big business subcontractor provides the dredging equipment and even financial resources to the small firm. He further stated that some large dredging firms charter their equipment and act as subcontractors in a manner which circumvents and defeats the purposes of the set-aside program. His remedy for the small dredging companies was to take a size appeal to the SBA in protest against the small business status of the alleged low bidder.

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[16] James H. Folk, Response to the Federal Register notice (March 17, 1987); Prepared for the Size Policy Board, U.S. Small Business Administration, April 16, 1987.

The overall results of the interview survey with regard to the subcontracting limitations provision were: (1) all but one of the interviewees felt that the "50 percent rule" would increase small business participation in the Federal procurement programs. (One of the interviewees suggested that not only would the provision increase small business participation in the Federal procurement program, but it would also have a positive effect on small business employment. This projection was made because small business will now have to perform 50 percent of the cost of the set-aside contract with its own labor force); and (2) all of the interviewees agreed that the "50 percent rule" will have a deterring effect on small business attempting to front for large business.

Analysis of the Questionnaire Surveys[17]

The COC specialists were surveyed explicitly concerning the 50 percent subcontracting limitation. The questions they were asked and the results of their survey will be presented below:

Question: What effect do you think the "50% rule" will have on small business participation in the federal procurement programs?

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[17] Result totals may not add to 100 percent due to rounding

Results: Increasing effect 9%
Decreasing effect 79%
No effect 12%

Discussion: A vast majority of the respondents indicated that the definite percentage (50%), instead of the previous "significant portion", will have a definite negative effect on small business participation in government contracting. Moreover, the respondents indicated that the "50% Rule" would result in additional COC referrals, and that contract officers would request a COC if there is any questions regarding the "50% rule".

Question: What effect do you think that "the 50% Rule" will have on small business attempting to front for large business?

Results: Deterring 48%
No effect 52%

Discussion: Forty-eight percent of the respondents indicated that the "50% rule" will decrease such "front" bidding and the result would be more legitimate bids. However, 52 percent of the respondents felt that it would have no effect. On the other hand, some of the COC specialists felt that if this provision (50% rule) was not properly enforced, that it could lead to an increase in small business fronting for larger ones.

Question: Should the legislation be interpreted as "in the case of contract for services or supplies, the concern may subcontract no more than 50% of the cost of the contract to large business?"

Results: Yes 55% No 45%

Discussion: Most of the COC specialists indicated that the rewording of the proposed provision on the 50 percent subcontracting limitation would permit several small businesses to form a team to perform at least fifty percent of the contracted effort. The rewording would also prevent a small business "front" situation where a large business would dominate the effort, thereby defeating the purpose of a set-aside.

Question: Do you feel that the subcontracting limitations (25 percent for specialty construction and 15 percent for general construction) will decrease small business participation in these areas?

Results: Yes 42% No 58%

Discussion: A majority of the COC specialists felt that the proposed restrictions on construction contracts would not decrease small business participation in these areas.

Question: If you feel that the subcontracting limitations for general and specialty construction will decrease small business participation in these areas, please estimate how much you think the decline will be in each category.

Results: The COCs estimate that there will be a greater reduction in the general construction category than in the specialty construction category. Forty-one percent of the COCs felt that a 20% reduction in the general construction can be anticipated and 26% of the COCs feel there will be a 30% reduction in general construction. Forty-one percent of the COCs felt that a 10% reduction in specialty construction will occur and 26% of the COCs expected a 20% reduction in specialty construction. Moreover, nineteen percent of the COCs estimated that there will be no decline in small business participation in either category.

Question: What effect do you think the "50% Rule" will have on small business set-asides and awards?

Results:

Positive	33%
Negative	48%
No effect	18%

Discussion: Forty-eight percent of the COC specialists felt that the "50% Rule" would definitely decrease small business set-asides and awards. They further stated that any efforts to reduce the small business set-asides and awards would only drive more government work out of the U.S. (where high levels of subcontracting remain).

Question: In general, do you think that P.L. 99-591 and P.L. 99-661, if implemented as intended, will increase the small business share of federal procurement?

Results: Yes 18% No 82%

Discussion: A vast majority of the COC specialists did not think that P.L. 99-591 and P.L. 99-661 would increase the small business share of federal procurement.

The Federal Activity Survey. The U.S. Small Business Administration sent questionnaires to all Federal purchasing activities to obtain procurement information necessary to comply with the requirements of P.L. 99-661.[18] One of the questions asked on the questionnaire referred to subcontracting limitations and it is restated below:

> "For each of the eight items that your activity purchases, we would like you to estimate the percentage of dollar volume subcontracted to others by your prime contractors."

Product Service	Percent Your Prime Contractor Subcontracts to Other Firms
Construction	________%
Construction of Building	________%
Dredging	________%
Special Trades Construction	________%
Shipbuilding & Ship Repair	________%
Refuse Systems	________%
Architecture and Engineering services (other than military equipment and weapons)	________%
Surveying Services	________%

The results are presented in Figure 4.2. From the study results, however, it would appear that the subcontracting limitation provision would not have an adverse effect on most of the reviewed industries. The highest estimated percentage subcontracted to other firms was 46 percent in the construction of buildings category. The construction of non-building and special trades construction had the next highest percentages with 32 percent

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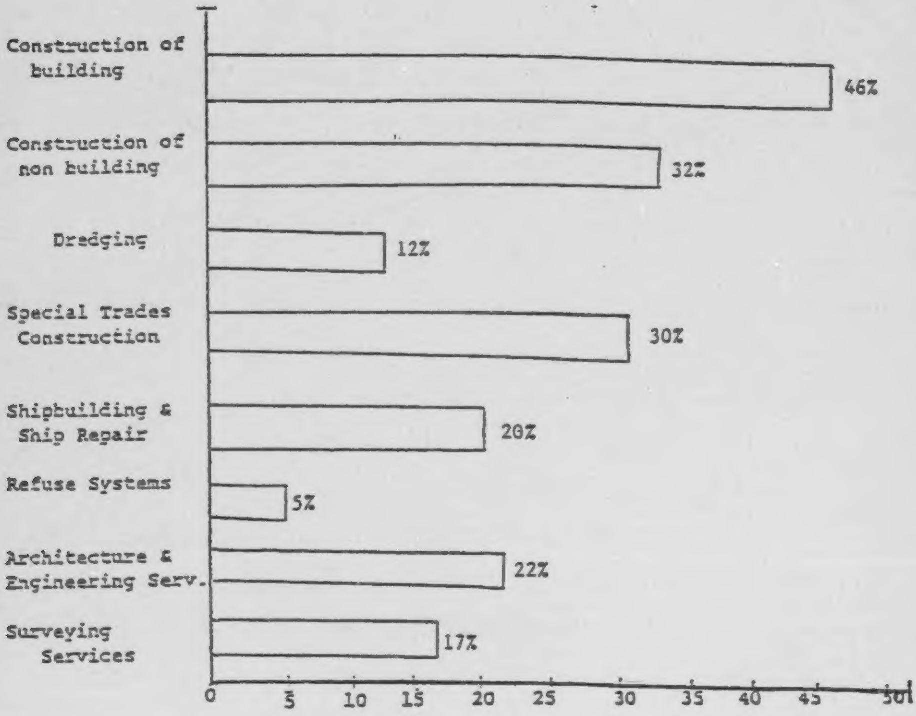
[18] One of the limitations of the survey was that it did not broadly address manufacturing and services.

Figure 4.2

PERCENTAGE OF SUBCONTRACTING



and 30 percent, respectively. The industries with the lowest subcontracting percentages were refuse systems, dredging, and surveying services with 5, 12, and 17 percent, respectively.

Feasibility of the 50% Rule

The "50% rule" requires as a condition precedent to award of a contract, that concerns "agree" to limitations regarding the minimum percentage of the cost of a contract that is to be performed by the concern. For services and construction contracts, the measure of work performed provided for in the statute, is "the cost of the contract". In the case of contracts for procurement of "supplies", the manufacturing cost is to be reduced by the cost of material and parts customarily purchased in the industry. This latter material is referred to below as "non-customary subcontracting".

Representative Mitchell's remarks in the October 15, 1986 Congressional Record characterize "performing work" for a manufacturing contract as direct labor, overhead and profit. Profit is not, however, an element of the cost of manufacturing the supplies, but rather the difference between the total cost of a contract, including both manufacturing and non-manufacturing cost, and the face value or selling price of the contract. The Congressional Record comments recognize this by substituting "face value" for "cost of manufacture" in discussing the provision applicable to manufacturing suppliers [Sec. 15(O)(1)(B)].

SBA set up a model for implementing the amendment based on the statute, that is using cost rather than value as the basis of measurement. SBA used guidance as to intent from the Congressional Record, but did not consider profit since it is not an element of cost. The model indicates that the statutory language has the potential to discriminate well between contracts with and without substantial labor or non-customary subcontracting.

There is, however, a problem in implementation for manufacturing suppliers. Specifying what is non-customary subcontracting appears to be a formidable task since not only will this vary from industry to industry but individual firms will vary as to their ability to meet specifications. Thus a specification of ±.0005 in a machined part may accommodate most potential machine shops bidding on a contract. The same part specified at +.0001/-.0000 may require most potential contractors to buy the part, and subsequently not be qualified. Regulations to define "non-customary" bid-by-bid rather than industry-by-industry might successfully address this problem.

Summary

While there was public comment on the "50% rule" as a result of the Federal Register announcement, no precise data were presented which would justify modification of the rule. Additionally, preparation of a model and experiments with it tentatively supported the view that the rule could be applied consistently. The principal problem with the rule is the administrative difficulty of enforcement. That difficulty would be eased by permitting the application of measurement to the value of the contract in question rather than to "costs" which are more subject to variable accounting methods.

3. The Annual Goals Of Each Procuring Agency, Established Under Section 15(g) Of The Small Business Act, Will Be Premised Upon All Awards, Rather Than Upon Those Above $10,000.

In order to analyze the advisability and feasibility of this provision, the law (P.L. 95-507) that promulgated the original goal setting procedure must first be examined.

Concerned by a lack of progress in awarding Federal contract dollars to certain socioeconomically disadvantaged groups, Congress through the enactment of P. L. 95-507, mandated that the head of each Federal agency, after consultation with the Small Business Administration, establish realistic goals for each fiscal year for the awards of contracts and subcontracts to small business concerns and small business concerns owned and controlled by socially and economically disadvantaged individuals.[19]

In 1980, the goal-setting procedure was extended to the labor surplus area and women-owned small business preference programs. Currently, each federal agency establishes separate annual goals for contract/subcontract dollars to be awarded under the Federal procurement preference programs.

Federal contract goal setting policy. According to Black (1983), economists have identified six cases of market failures (externalities) that are used to justify government intervention: positive externalities (public goods), negative externalities (e.g., pollution), natural monopolies, high risk and uncertainty, information failures, and the existence of market barriers to entry and exit.

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[19] Title I, Amendments to the Small Business Investment Act of 1958, Public Law 95-507, 92 Statute 1757, 95th Congress, October 24, 1978.

By examining the legislative language, it appears that both Congress and the executive branch have attempted to effect a rational economic justification for the federal procurement preference programs. In theory, one of the basic assumptions of an efficient market is the absence of barriers to market entry and exit. Freedom to enter or exit the market place enhances competition, therefore allowing the forces of supply and demand to equilibrate at a pareto-optimal level (an allocation of resources in which no one individual can be made better off without making someone else worse off). Although an economic rationale has been used for the formation of a Federal anti-discrimination policy, it does not necessarily follow that a Federal, - small business participation policy is the logical response to solving the problem.

Implementing Federal contract small business goals. Although economic theory has been used as a rationale for a Federal anti-discrimination policy, the public choice and implementation literature holds a wealth of evidence that argues a Federal contract goal-setting policy, will not help and, in some instances, may even exacerbate the situation. From the public choice and policy implementation literature, nine factors have been identified by Black as reasons for predicting failure in implementing the Federal contract goal-setting policy:[20]

(1) Vague and ambiguous legislation. A review of the legislative language enacting the Federal procurement preference programs reveals that much has been written in vague and ambiguous terms.

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[20] Dennis E. Black, "An Evaluation of Federal Set-Aside Goals in Reducing Socioeconomic Discrimination," National Contract Management (Winter 1987, p. 162.

(2) Hard-to-measure output. Agency output has been extremely difficult to measure in terms of both quantity and quality. Although agency performance can partly be measured by the annual total number of contract dollars awarded to a targeted groups, it is not clear how much is enough. Qualitative measures of agency performance are especially difficult to develop since the non-market output is unrelated to any bottom-line measure comparable to the profit-and-loss statement in a market environment.

(3) Creaming. Since performance is monitored by the annual number of contract dollars awarded, a logical agency response is to "cream" awards to entrepreneurs in the targeted group that are most likely to successfully complete the contract requirements. Substantial vertical inequity through creaming has occurred under the goal-setting procedures, particularly with minority 8(a) contract set-asides.

(4) Goal displacement. Since agency performance is monitored by the annual level of Federal contract dollars awarded to a targeted group, concern over the number of targeted groups that are reaching economic self-sufficiency becomes secondary. One would expect the number of firms wishing to participate in the program to increase over time; however, monetary goals have overridden the intended goal of developing socioeconomically disadvantaged entrepreneurs for successful participation in the competitive marketplace. Goal displacement therefore, has an especially perverse impact on Federal procurement performance programs, since political advantage goes to those agencies that cream.

(5) Incompatible policy goals. The long-stated practice of Federal contracting has been to acquire goods and services through competitive means. The premise is that only through "full and open competition" can the contracting officer (CO) fulfill the stated objective of acquiring the highest quality goods and services at the lowest price, which is misleading and false. The Federal contracting process is also being used to implement many socioeconomic programs that restrict competition by requiring the CO to set aside agency contracts from the forces of the marketplace. A policy contradiction is thereby created for the agency charged with simultaneous implementation of both procurement and non-procurement objectives through the Federal contracting process.

(6) No budget. By implementing various non-procurement objectives through the Federal contracting process, program costs are simply passed through the agencies' existing contracting budgets. Without direct budget support, minimal implementation effort by an agency is the rational response.

(7) Multiple actors. The process of negotiating agency goals is fragmented among the agencies and four separate offices within the Small Business Administration, as well as a fifth office within the General Services Administration (GSA). Annual goals are negotiated for the agency by its small and Disadvantaged Business Utilization Specialists, yet the agency's COs are ultimately responsible for the award of Federal contract/subcontract dollars to the targeted groups.

(8) No incentive enforcement mechanisms. Agencies are unlikely to comply with the goal-setting procedure unless they are provided incentives to offset the effects on increased administrative costs and contract prices. Enforcement mechanisms have also been effectively nonexistent. Although an agency's monitored output is reported annually to the policy makers, the

goal-setting procedure provides for non-effective penalties against those agencies that fail to meet or exceed a set-aside goal.

(9) Lowballing. Since performance is measured by the annual level of Federal contract/subcontract dollars awarded to a targeted group relative to the negotiated goal, there must be a tendency to negotiate annual goals that they are certain they can meet or exceed. During the negotiation process, an agency's goal-setting decision is therefore significantly influenced by its previous year's achievements. Taking a conservative approach, the establishment of soft goals is the rational response.

From Table 4.2 through 4.3, Black argues that the goal-setting procedure has not had a significant impact on small businesses and minority businesses. Since implementing goal-setting in 1980, there has been only a small increase in the annual share of Federal contract dollars going to the four targeted groups examined. Although there has been a significant increase from FY 80 of 17 percent to 20 percent in FY 86 in the small business share (Table 4.2), the increase between years have been relatively small. Similarly, there has been a significant increase in the minority business share (Table 4.3) from FY 80 to FY 86, with 8 percent and 12 percent, respectively. However, minority businesses have maintained relatively constant shares from FY 80 to FY 83; and their share slightly decreased from FY 84 to FY 85 and increased again in FY 86. Therefore, the data tends to support the argument that goaling had only a small impact on increasing the small business and minority business share of the total Federal contract budget.

The elimination of the ten thousand dollar threshold for goaling will be a material improvement in the process. Various agencies, notably DOD, have adjusted their record-keeping to correspond to the change of small-purchase ceiling of $25,000. Since the goaling threshold, originally matching the small-purchase threshold, remained at $10,000 the choices for goaling were awkward: maintain a separate report format, just for goaling above $10,000; goal from $25,000, the new small-purchase ceiling; or, goal from zero. Different agencies were interested in solving the problem in different ways. The mandate to eliminate the goaling threshold-goal from zero is a welcome amendment.

TABLE 4.2

Small Business Awards

($ = Millions; Data = CPI Adjusted, 1967 = 100)

Fiscal Year	Total Federal $	Total Small Business $	Total Small Bus. as % of Total Federal
80	40,077	6,649	17
81	44,298	7,521	17
82	47,101	7,668	16
83	52,307	9,620	18
84	53,487	10,146	19
85	54,730	10,289	19
86	53,612	10,873	20

Source: U.S. Small Business Administration, SBA Summary/Analysis/Comments Worksheets

TABLE 4.3

Small Business Awards

($ = Millions; Data = CPI Adjusted, 1967 = 100)

Fiscal Year	Total Federal $	Total Minority Business $	Total Min. Bus. as % of Total Federal
80	40,077	3,015	8
81	44,298	4,112	9
82	47,101	4,048	9
83	52,307	4,568	9
84	53,487	5,646	11
85	54,730	5,705	10
86	53,613	6,206	12

Source: U.S. Small Business Administration, SBA Summary/Analysis/Comments Worksheets

Goaling by SICs. Agency heads are required by the amendments to make "consistent efforts" to expand participation by small/small disadvantaged business in each industry category. The problems to be resolved in this requirement are:

(1) The present reporting system does not report contracts by SIC assigned to the contract. Thus, as noted elsewhere, there is significant error in working with SIC-based statistics. It is SBA's present understanding that reports by contract SIC will not be available before FY 89.

(2) Processing the data for over 800 SICs will be difficult at best. Meaningful analysis of the information yielded will require several years data for comparison purposes.

(3) Addressing all SICs casts too broad a net. Even if analysis of all of them is completed on a timely basis, it is impractical to expect meaningful management emphasis on literally hundreds of categories of goods and services. It is also unrealistic to expect genuine attention by operational personnel to more than a few identified categories.

Summary

SBA believes that goaling enhances small and small disadvantaged business participation in the Federal marketplace. In order to make goaling meaningful in terms of the requirements, SBA proposes a consistent structure for the agency attempts to expand participation by industry category.

SBA suggests that agencies obtain from the Federal Procurement Data Center (FPDC) data be obtained by agencies which establishes, on a government-wide basis, the level of participation by small and small disadvantaged business in each of the most significant SICs, i.e., those in which the major portions of dollar value are being awarded. SBA would identify these annually, from FPDC data. While this must, initially, be based on the SIC of the contractor, rather than by contract, by using the most significant areas the error will be less significant. (As noted elsewhere in this report, the SICs in which the greatest values are awarded and, therefore, in which the major opportunities lie, are few in terms of the total number of SICs.) Agencies will then obtain from FPDC a record for the major SICs of: average government small and small disadvantaged business participation; highest level of participation and the subject agency's participation. This will permit each agency to address a manageable span of issues by establishing the reasons for their variance and identifying means to enhance participation where it is possible.

It is SBA's view that this approach will focus attention on those areas most susceptible to increased participation by small business.

4. The Objective Of Achieving A Fair Proportion Of Government Contracts For Small Business Is Now Directed At Each Standard Industrial Classification (SIC) Code Industry, Rather Than At The Totality Of Government Procurement, as Previously Held.

According to Mitchell,[21] one of the authors of section 921 of P.L. 99-661, this provision should assure that small businesses receive a fair share of each product and service purchased by the Government. He further states that:

> "Under this bill, small business potential in every category of purchases must be ascertained, and buying agencies must make efforts on an individual industry-by-industry basis to insure that small business receives a fair share of each product and service being purchased. On the other hand, the domination of a market through set-asides is prohibited. Consequently, small business potential in every industry is to be exhausted. If small business participation levels remain very low, only then should consideration be given to raising the size standard. Conversely, if set-aside participation levels are very high, SBA should give consideration to lowering the size standard."[22]

The goal of a "fair proportion" for small business in each SIC is intended to increase the opportunities for small business to participate in a broader variety of procurements on an industry-by industry basis, rather than limiting their participation to a few industries where small business has historically received a large share.

Faucett[23], in his study on industrial share, was able to identify the SICs for $128 billion of the $162 billion of contract actions in FY 1983; and to rank Federal procurement by 4-digit SIC codes, for the top ten SIC's for FY 1981 through 1983. These rankings are shown in figure 4.5. Several conclusions can be drawn from these statistics. First, in 1983 almost 60 percent of procurement dollars were found in ten out of the approximately 800 4-digit SIC's. Second, the SIC composition of procurement is relatively stable. For example, between 1982 and 1983, there was only one change in the rank of the top ten 4-digit SICs. In addition, nine of the top ten SICs in FY 1983 were in the top ten in FY 1981.

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[21] Parren J. Mitchell, The congressional Record, (October 15, 1986, pp. H -10140-H - H-10142

[22] IBID.

[23] Jack Faucett, Johnathan Skolnik, and Harry Chmelynski, "Procurement Share vs. Industry Share,"(Jack Faucett Associates, Chevy Chase, MD: February 1987).

These statistics suggest that government procurement dollars are highly concentrated in a small number of industries. Therefore, a provision such as this one (to achieve a fair proportion of government contracts for small business by mandating government agencies to direct Federal procurement to SIC levels) is expected to improve small business participation because it would provide an avenue for small business to participate in areas where awards have traditionally been awarded to large businesses.

However, this provision may be difficult to implement because of the vagueness and ambiguity of the term "fair proportion". There has been considerable disagreement over what a "fair share" of Federal contract dollars to small business should be, which Congress has to date made no attempt to define.

In order for this provision to be most effective a "fair proportion" should first be defined, especially if agencies are to goal toward such an objective. Currently "fair share" appears to have been operationalized through an objective of "increasing share", however small the increase from year to year and however small compared to other SICs.

Figure 4.5

RANKING GOVERNMENT PROCUREMENT BY SIC

	1983		1982		1981	
	Rank	%	Rank	%	Rank	%
3711 Aircraft	1	17.3	1	15.7	1	14.4
3662 Radio & TV..	2	10.1	2	9.4	2	9.2
3731 Shipbuilding	3	7.7	4	5.2	5	4.8
3761 Guided Miss.	4	4.7	3	5.4	4	5.1
3724 Aircraft Engs.	5	4.1	5	4.7	3	5.5
7391 Res. & Dev.	6	3.9	6	4.3	6	4.4
7392 Mang. & P.Rel.	7	3.0	7	3.9	8	2.3
8911 A & E Services	8	2.5	8	2.7	11	2.1
2819 II Chemicals	9	2.4	9	2.1	10	2.2
8221 Cols. & Univs.	10	2.0	10	1.9	9	1.6

Source: Faucett & Associates (1986) pp. v.

To illustrate some of the difficulties of implementing this provision, statements from three Federal agencies are presented below:

Department of Energy (DOE)

> "Our first difficulty relates to paragraph (a) of Section 921 which modifies 15 U.S.C. 644(a) to require small and small disadvantaged business goaling on the basis of Standard Industrial Classification (SIC) codes. Current goaling systems consist of projections based upon iterative historical data tempered with procurement planning information. We question whether organizations generating procurement requirements can meaningfully project their needs in a prospective fiscal year to an SIC code level.
>
> This agency does not have historical SIC code data to establish meaningful goals and we doubt that other executive agencies do either. It appears that there is only a limited ability to translate the retrievable commodity data we now collect to the SIC code system, and the total effort to modify the process to collect this information will be very extensive and costly. To underscore the impact of this new provision, the current target date for collection of SIC code data by the Federal Procurement Data System (FPDS) is one year after the effective date of this goaling provision of Section 921. We believe the DOE is ahead of most agencies in the sophistication and accuracy of our data system, which would mean that other Federal agencies will have an even more difficult time implementing this provision. When we are able to institute such a system, we will be generating historical information from that point forward, i.e., it will take at least a full year to have minimum data on which to base meaningful goals. A significant point to be made is that this data is of absolutely no use to the Department outside of fulfilling these statutory goaling requirements."[24]

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[24] Berton J. Roth, Director of Procurement and Assistance (DOE), Comments concerning P.L. 99-661, prepared for Senator Alan J. Dixon (U.S. Senate), January 29, 1987.

Department of Defense (DOD)

"Difficulties will be experienced in accomplishing the provisions of Sec. 921(a) of Public Law 99-661. This section requires DOD to award a fair share of its prime contract awards to small business in each specific industrial classification. In the past, the fair share standard has been based on the total of DOD prime contract awards. Naturally, this requirement adversely affects our goaling process in that separate goals will have to be established for over 800 Standard Industrial Code (SIC) classifications for products and 303 SIC's for services. It must be recognized that no procurement award history has been kept based on SIC identification but rather on Federal Stock Class identification. In this regard, the Small Business Administration published in the Federal Register the new SIC's on January 6, 1987 to be used by the general public and Federal agencies. This information must now be cross-referenced to existing Federal Stock Class identification, and time is required to train personnel to accomplish the requirement.

To award a fair share by each SIC requires at least three elements of information. These are a determination of what the fair share is, what the fair share should be (which requires a comprehensive knowledge of capability and capacity of the nation's small business community), and data on the last two years' procurement history for each SIC. This represents a major administrative task when considering that a goal must be developed for each of approximately 1100 individual products and services."[25]

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[25] The Undersecretary of Defense (DOD), Comments concerning P.L. 99-661, prepared for Senator Alan J. Dixon (U.S. Senate).

National Aeronautics and Space Administration (NASA)

> "We anticipate some problems in implementing this provision by October 1, 1987. For example, in the NASA procurement reporting system, the product or service being bought is currently recorded using the Federal Procurement Data System coding manual. This coding system identifies the principal product or service as opposed to the standard industrial category within which the contractor does business. At a minimum, conformity with the new statute would involve modification of the NASA individual contract reporting form to collect the SIC code for each procurement and changes in the NASA automated data collection system as well as in the Federal Procurement Data System (FPDS).
>
> A second problem is that, in order to create realistic small business goals on an industry-by-industry basis, data must be available on past and present small business participation in the NASA procurement program by individual industry. Since NASA has not collected SIC code data, we currently have no data base upon which to establish goals for each industry category. We understand that the Small Business Administration, as a result of a study done by contract, has a crosswalk between the SIC codes and the FPDS codes. We also understand that the FPDS DUNS number system is capable of producing primary and secondary SIC codes for each contractor identified in its system. Both of these tools could be used to do an analysis of past and present NASA procurements with small business on an industry-by-industry basis. However, we would caution that this method would be very imprecise. It will take several years of direct assignment of SIC codes to our contracts before we would feel confident of further goal projections."[26]

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[26] NASA, Comments concerning P.L. 99-661, prepared for Senator Alan J. Dixon (U.S. Senator).

An approach to making use of the "goaling" system for these purposes is addressed above in specific discussions on "goaling".

Analysis of Structured Interview Survey

All of the interviewees unanimously agreed that this provision would have a positive effect on small business participation, on an industry-by-industry basis, in the Federal procurement process.

Analysis of the Questionnaire Survey

Each PCR was asked: "What effect do you think Section 921(a) (which directs a fair proportion of Government contracts to each SIC code) will have on small business participation on an industry-by-industry basis?" Seventy-five percent of the PCRs felt that this provision would have a decreasing effect on small business participation, 17 percent felt that this provision would have no effect and only 8 percent felt that it would have an increasing effect. They further stated that small business participation is not expected to significantly increase in any of the SICs in which there is now virtually no participation. They were also concerned that this provision would be an added work load for the procuring agencies; and this added work load is expected to cause a reduction in the appreciation for the set-aside program.

Summary

On balance, SBA considers that goaling will focus attention on those SICs in which small and small disadvantaged business is now at minimal levels of participation.

5. Size Standards For Small Business Eligibility Will Be Based On SIC Industries, By Law.

The Standard Industrial Classification ("SIC") is a taxonomy used by the Bureau of the Census to divide firms (enterprises) and their individual manufacturing plants (establishments) into uniform categories that reflect similarities between uses for the products they produce, or the manufacturing technologies they employ.

Today, SICs are the most popular delineator of economic markets used by empirical industrial organization practioners. However, there are many known defects of using the SIC system to separate firms or plants into distinct economic markets. Its main shortcoming is that it is an order-of-magnitude approach rather than a precise tool employed to separate economic markets. Moreover, this factor indentifies the problems of goaling at the SIC level.

Over the years, there has been a question as to how well SIC succeeds at identifying the different levels of "closeness" between economic markets. It has been concluded in past studies that the SIC system is not especially helpful in identifying groups of firms that display similar dependent variables. Furthermore, the SIC seems to be more effective at dividing firms into coarse industrial groups, e.g., mining vs. construction vs. manufacturing, than it is at dividing firms into finer 3-and 4-digit segments thought to represent economic markets more closely.

Clarke,[27] an economist at the U.S. Department of Justice, conducted a study on whether SIC does a useful job of separating firms into homogeneous economic markets. He concluded that generally the SIC is quite weak in classifying firms into the level necessary for economic market division. Clarke's results indicate however, that the SIC was more successful at grouping firms into coarser classifications. He emphasized that one should be troubled by this finding as the preponderance of cross-section industrial organization studies have used the SIC to proxy economic markets.

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[27] Richard N. Clarke, "SICs as Delineators of Economic Markets", Economic Analysis Group Discussion Paper, U.S. Department of Justice (1986), Washington, D.C.

Moreover, it was concluded by Clarke that a more useful classification system would be of great value to industrial organization economists. Therefore, until a more useful classification system is proposed and implemented, empirical industrial organization research should be carefully evaluated to determine its sensitivity to use of a possible specious classification system.

In conclusion, although there are many known defects in the SIC system, it still remains the most popular delineator of economic markets. SBA has used it in the past by administrative choice, and has no objection to continued use. However, should industries exist or come into being which do not fit the SIC structure, the flaws of which are noted in this report, SBA may be unable to deal directly with the problem because of the restriction by the law to the SIC system.

6. Contracting Officers Will Be Required, Upon Request, To Provide A List Of Expected Small Business Offerors When A Small Business Set-Aside Is Made.

According to the Department of Energy:

> "Currently the decision to set a procurement aside is made in the early processing of a procurement request. A complete bidders list, however, is not generated until the notice of procurement has appeared in the Commerce Business Daily. With this new requirement, either the capability to create a list sooner will have to be developed or the set-aside decision postponed.
>
> Either alternative is possible to effect administratively, but both are disruptive and would create a negative impact on an efficient and effective procurement system. This statutory change appears to have been made only to allow public review of potential offerors or proposers in hopes of preventing misrepresentation of size. DOE's experience shows that very little misrepresentation occurs. The benefit, if any, from such public disclosure seems to us vastly outweighed by the additional administrative costs and the adverse impact (in terms of requiring more non-productive work and time) on the procurement process."[28]

Analysis of structured interview survey

Each of the interviewees was asked the following question: What effect do you think this provision will have on contracting officers as far as making set-aside awards? They were asked to choose one of the following choices: encouraging effect, discouraging effect, or no effect.

Thus, the interviewees responded as follows: four of the respondents thought that this provision would have a discouraging effect, one thought it would have an encouraging effect, and one respondent thought it would have no effect on the contracting officer making set-aside awards. Therefore, a majority of the interviewees felt that this provision would discourage contracting officers from making set-asides.

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[28] Roth, Op. Cit.

Analysis of Questionnaire Survey

Each PCR was asked if they thought section 921(e), which requires the contracting officers to provide a list of expected small business offerors, would have an impact on contracting officers making set-asides. Seventy-six percent of the respondents felt that this provision would discourage contracting officers from making set-aside awards, 24 percent felt that this provision would have no effect, and none of the respondents felt that it would have an increasing effect. Some of the PCRs stated their belief that the contracting officers are already lukewarm to any preference programs that reduce their "competitive" awards, therefore this provision would simply discourage them more. They also stated that this provision will cause an added work load for the contracting officer and he/she will attempt to elude it.

Summary

SBA believes that the increased burdens on contracting personnel would detract from the use of set-asides and would be an overall detriment on the general community of small business interested in the government procurement program.

Section 6

SUMMARY AND CONCLUSIONS

The objective of this research was to consider the advisability and feasibility of the amendments to the Defense Acquisition Improvement Act of 1986 (Public Law 99-591) and the Department of Defense Authorization Act, 1987 (Public Law 99-661) to the Small Business Act. Public Law 99-591 and Public Law 99-661 contain several identical provisions which substantially modify the procurement assistance programs authorized by the Small Business Act which encourages the participation of small and small disadvantaged business in the federal procurement process.

To evaluate effectively the effects of Public Law 99-661 on the SBA programs, the SBA conducted and carried out a number of research efforts. The results of this study are presented below:

(1) The "fair market price" amendment was found to be advisable and feasible. SBA considers "fair market price" to be synonymous with the term fair and reasonable price. Moreover, from the questionnaire survey, some of the respondents felt that the procuring agencies would consider "fair market price" and "fair and reasonable price" to be synonymous.

(2) The questionnaire survey results indicated that more than 48 percent of the respondents felt that the 50 percent subcontracting limitation would have a deterring effect on small business attempting to front for large business. Likewise, 100 percent of the interview survey participants agreed that the 50 percent subcontracting limitation would also have a deterring effect.

(3) The study findings, in general, support the goal setting provision of P.L. 99-661. However, it was shown that the implementation of this provision could, if past correlations remain true, have only a relatively small effect on total Federal contract dollars awarded to both small and small disadvantaged businesses.

(4) With regard to section 921(a), concerning a fair proportion of government contracts by SIC codes, there will likely be an initial decrease in small business participation in the Federal procurement program as a result of reduced size standards in some SICs. Ultimately, however, if agencies aggressively pursue this objective, to enlarge the number of SICs where small and small disadvantaged businesses have increased award opportunities, their share should increase.

(5) The results from the questionnaire survey indicated that the requirement to provide a list of expected small business offers would have a discouraging effect on the contracting officers making set-aside awards. In addition, this provision is expected to cause an added work load for the contracting officers. Therefore, when the extra work is required to make a set-aside, the tendency will be not to make it.

(6) The law requires size standards for small business eligibility to be based on SIC codes. SBA already uses the SIC system for size standards purposes; therefore, this provision will have no effect on SBA programs. Although some shortcommings are found in the SIC code system, it is still the most popular delineator of markets today.

In conclusion, five out of six of the amendments promulgated by section 921 of P.L. 99-661 were found to be advisable and feasible. These are: the fair market price amendment, the 50 percent subcontracting limitations amendment, the goaling amendment, requiring that a fair proportion of government contracts be directed at each SIC code and the use of SIC codes for the establishment of size standards. However, the findings of the study also indicated that the amendment requiring the listing of prospective small business offerors would not be advisable or feasible to implement.

VOLUME II

ADVISABILITY AND FEASIBILITY
OF IMPLEMENTING
SECTION 921(f) of PUBLIC LAW 99-661

Prepared for:

Committee on Armed Forces
and the Committee on Small Business
U. S. House of Representatives
Washington, D.C.

and

Committee on Armed Services
and the Committee on Small Business
U.S. Senate
Washington, D.C.

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July 14, 1987

EXECUTIVE SUMMARY

Public Laws 99-591 and 99-661 require a determination of whether the value of small business set-asides and 8(a) awards in FY 1984-86 together exceeds 30 percent of Federal procurement in the following industry groups: construction; engineering, including architecture and surveying; shipbuilding and ship repair; and refuse systems. The broad industry groups comprise 29 separate industries.

In industries where more than 30 percent of Federal procurements were set aside, SBA must propose new size standards which are likely to reduce the set-aside amount to no more than 30 percent. Also, the law permits, but does not require, the segmentation of size standards according to type of equipment used and region of the country. In explanatory remarks in the Congressional Record in October 1986 and in a letter to SBA in November 1986, the former House Small Business Committee Chairman, Parren Mitchell, urged segmentation for the dredging and shipbuilding and ship repair industries.

The report's initial finding is that the 30 percent set-aside level was exceeded in all construction industries except heavy construction, not elsewhere classified (N.E.C) and dredging (SIC Code 1629). The 30 percent level is also exceeded in land surveying services (SIC Code 8713). Thus there are 26 industries requiring size standard changes to be proposed. Table 1 shows the percentage of set-aside and 8(a) awards for the 29 industries involved in the study during FY 1984-86.

TABLE 1

SMALL BUSINESS SET-ASIDES AND 8(a) CONTRACT AWARDS AS A PERCENT OF ALL FEDERAL PROCUREMENTS, FY 1984--FY 1986 AVERAGE

STANDARD INDUSTRIAL CLASSIFICATION	INDUSTRY DESCRIPTION	PERCENT SET-ASIDE AND 8(a) AWARDS
1521	Single Family Housing Construction	45.3
1522	Residential Construction, N.E.C.*	39.0
1531	Operative Builders	45.7
1541	Industrial Builders and Warehouses	54.6
1542	Nonresidential Construction, N.E.C.	64.0
1611	Highway and Street Construction	53.3
1622	Bridge, Tunnel & Elevated Highway Construction	52.6
1623	Water, Sewer, and Utility Line Construction	71.1
1629	Heavy Construction, N.E.C.*:	
	All Except Dredging	20.9
	Dredging	16.6
1711	Plumbing, Heating, Air Conditioning	69.9
1721	Painting, Paper Hanging and Decorating	89.6
1731	Electrical Work	62.5
1741	Masonry and Other Stonework	68.9
1742	Plastering, Drywall and Insulation	67.7
1743	Terrazo, Tile, Marble, and Mosaic Work	78.7
1751	Carpentering	91.7
1752	Floor Laying and Floor Work, N.E.C.*	88.2
1761	Roofing and Sheet Metal Work	89.3
1771	Concrete Work	91.5

(cont.)

STANDARD INDUSTRIAL CLASSIFICATION	INDUSTRY DESCRIPTION	PERCENT SET-ASIDE AND 8(a) AWARDS
1781	Water Well Drilling	55.4
1791	Structural Steel Erection	45.9
1793	Glass and Glazing Work	89.8
1794	Excavating and Foundation Work	84.4
1795	Wrecking and Demolition Work	79.8
1796	Installing Building Equipment, N.E.C.*	52.6
1799	Special Trade Contractors, N.E.C.*	51.7
3731	Shipbuilding and Repairing	7.7
4953	Refuse Systems	22.4
8711-13	Engineering, Architectural and Surveying:	16.1
	Engineering For Military Equipment and Weapons	14.2
	Engineering and Architecture Services, Not For Military Equipment and Weapons	24.5
	Marine Engineering and Naval Architecture	7.2
	Land Surveying Services	74.0

* N.E.C. = Not Elsewhere Classified
SOURCE: Federal Procurement Data Center

The Agency has encouraged public participation in implementing the law. Notices appeared in the Federal Register and Commerce Business Daily in March 1987. Also, SBA issued a press release; notices were sent to 100 major industry trade organizations; and SBA personnel visited some major industry organizations to ensure wide public comment.

As of April 30, 1987, SBA received 72 comments from the March 1987 notice. Of 11 commenting on the segmentation issue for dredging, only 2 were in favor; for shipbuilding and ship repair of 9 commenting, 3 favored and 6 opposed segmentation. Eight firms commented as to whether a cut-off percentage of greater than 30 percent should be used; 6 were opposed to this. The appendix to the study has a complete description of the comments.

The report also explains in detail the data and methodologies used in devising the proposed size standards. The recommended method for setting new size standards compares the size of firms doing business in a particular Government market with the amount of set-aside or 8(a) contracts. At the point where the larger small firms have received contracts in excess of 30 percent, the size standard is set at that size of firm. The calculation of the proposed size standard for the single-family house construction industry, SIC-1521, illustrates the recommended method. For this industry there were $48.1 million in excess small business contracting. Table 2 shows the size of firm, ranked from large to small in employees, and the value of set-aside contracts awarded to the firm. Firms are ranked in terms of employees rather than sales because employee information is considered more reliable and timely than sales information. Column 5 calculates the cumulative value of set-aside contracts beginning with the largest firm. The standard is set at the firm size where cumulatively $48.1 million of contracts have been awarded to firms larger than that size. In the example, $48.1

TABLE 2

FIRMS RECEIVING SET-ASIDE AND/OR 8(a) CONTRACTS RANKED BY EMPLOYEE SIZE OF FIRMS
(Dollar Amounts are in Thousands (1986 RECORDS))

SIC=1521--SINGLE FAMILY HOUSING CONSTRUCTION

(1) DUNS NO.	(2) FIRM EMPLOYMENT	(3) FIRM SALES ($000)	(4) 8(a)/Set-Aside CONTRACTS $(000)	(5) CUMULATIVE TOTAL ($000)
62301791	200	13,000	2,009	2,009
03874807	100	8,000	300	2,309
79365888	100	0	8,475	10,784
06843544	80	5,000	1,031	11,815
07009970	70	4,500	935	12,750
62208103	70	4,490	12	12,762
95480893	70	3,190	14	12,776
06825145	69	6,410	3,923	16,699
30083604	60	7,710	59	16,758
09799019	60	3,000	773	17,531
49132020	60	2,140	1,744	19,275
71830905	60	2,000	364	19,639
31636110	52	2,340	5,260	24,899
06843031	50	0	674	25,573
98707706	50	0	40	25,613
13529771	48	0	6,811	32,424
91705020	45	2,130	730	33,154
41312752	40	4,000	307	33,461
06842801	35	14,700	6,604	40,065
05812789	35	3,700	313	40,378
68403799	33	6,850	1,088	41,466
95831178	30	1,300	30	41,496
37364270	30	1,070	64	41,560
32285388	30	0	39	41,599
02496073	28	5,000	3,091	44,690
94602554	27	3,190	40	44,730
53398178	27	2,000	63	44,793
41352949	25	20,000	378	45,171
06845142	25	6,000	631	45,802
33385188	25	3,770	124	45,926
18619056	24	4,000	129	46,055
21238670	23	2,100	11	46,066
65115230	22	0	11	46,077
55723506	21	3,000	766	46,843
13159736	21	2,000	782	48,100*

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* Point of 30 percent cumulative contract award value.

TABLE 2 (Cont.)

------------- SIC=1521--SINGLE FAMILY HOUSING CONSTRUCTION -------------

DUNS NO.	FIRM EMPLOYMENT	FIRM SALES ($000)	8(a)/Set-Aside CONTRACTS $(000)	CUMULATIVE TOTAL ($000)
36002129	20	7,000	6,431	54,056
21871207	20	3,000	89	54,145
08795445	20	2,000	449	54,594
17406041	20	0	1,181	55,775
08695941	20	0	476	56,251
84800143	20	0	267	56,518
37149606	20	0	170	56,688
47600895	20	0	38	56,726
94344447	18	4,000	1,778	58,504
39366794	18	2,100	-1	58,503
91699215	17	1,200	365	58,868
85266039	17	1,000	328	59,196
29526811	16	2,500	15	59,211
48383897	16	2,080	724	59,935
48045041	15	7,000	224	60,159
89405245	15	4,000	4	60,163
99667891	15	2,000	177	60,340
61459103	15	1,950	56	60,396
69802478	15	1,850	889	61,285
02786820	15	1,000	77	61,362
41734583	15	882	54	61,416
03503992	15	779	542	61,958
62677695	15	400	83	62,041
07658890	15	292	295	62,336
97149439	15	0	50	62,386
22683303	14	6,240	326	62,712
65648925	14	3,550	1,103	63,815
56408883	14	3,260	166	63,981
04033510	14	0	277	64,258
17426510	13	2,500	158	64,416
19192375	13	378	539	64,955
21945928	12	3,000	1,269	66,224
04430997	12	2,340	69	66,293
84816404	12	1,140	107	66,400
48365654	12	880	33	66,433
95745006	12	792	591	67,024
62105275	12	650	11	67,035
03370103	12	550	33	67,068
48393655	12	0	126	67,194
01245827	12	0	123	67,317

million of set-asides were awarded to firms that had more than 21 employees. Firm size by employee number is converted to a dollar equivalent (based on average sales per employee in the industry) and results in a $2 million size standard.

The specific size standards resulting from this method range from $9.5 million for general construction of residential buildings (SIC-1522) to $0.25 million for surveying (SIC-8713), and plastering and drywall (SIC-1742), as shown in Table 3. On average, the proposed size standards are reduced by approximately 80 percent.

The estimated impact of the new size standards is that $2.3 billion will change from the set-aside or 8(a) category to the unrestricted category. This estimate is based on the 1984-86 average annual level of procurement. It represents the dollar value of the shift away from small business set-asides required to comply with P.L. 99-591.

A broader impact is the change in small business status of firms in those industries where the size standards would change. About 50,000 firms, which in 1984 accounted for about $134 billion in sales, would be moved from the small to the other-than-small category. Of course, for those firms not actively involved in Federal procurement and other SBA programs, there would be no immediate impact from a change in eligibility associated with lower size standards.

In addition to the method recommended above, the SBA also considered four alternative methods of setting size standards as follows:

1) Set size standards in response to recommendations offered by various procurement offices which were surveyed by SBA. This approach would rely on a selected group of individuals who are very knowlegeable of the set-aside program.

SIZE STANDARDS FROM RECOMMENDED PROCEDURE DESIGNED TO RESPOND TO PUB. L. 99-591
(M = millions of dollars)

SIC	CURRENT SIZE STANDARD	PROPOSED
1521	$17.0M	2.00M
1522	17.0M	9.75M
1531	17.0M	1.25M
1541	17.0M	5.25M
1542	17.0M	3.50M
1611	17.0M	4.00M
1622	17.0M	1.75M
1623	17.0M	1.25M
1711	7.0M	1.25M
1721	7.0M	.50M
1731	7.0M	1.50M
1741	7.0M	1.50M
1742	7.0M	.25M
1743	7.0M	1.25M
1751	7.0M	.75M
1752	7.0M	.75M
1761	7.0M	1.00M
1771	7.0M	.50M
1781	7.0M	.75M
1791	7.0M	4.50M
1793	7.0M	1.00M
1794	7.0M	.50M
1795	7.0M	3.75M
1796	7.0M	2.75M
1799	7.0M	2.50M
8711 Surveying)	2.5M	.25M

2) Set size standards to eliminate from eligibility any firm winning any one of the larger set-aside or 8(a) contracts in the industry under review. By eliminating such firms one could assume these larger contracts would be unrestricted, because the pool of competent firms capable of performing the formerly set-aside or 8(a) contracts would be sharply curtailed.

3) Set the size standard in each industry such that firms defined as small nationally would cumulatively generate 45 percent of all receipts in the industry under review. This approach would provide a standardized receipts share measure for small firms of 45 percent.

4) Lower the size standard in each industry under review such that firms losing eligibility generate in aggregate the percent of total industry sales which the laws require to be shifted to the unrestricted category. This approach also ignores Government procurement patterns. By eliminating firms from eligibility based on national industry distributions, it is felt that the proportion of contracts in the form of set-aside or 8(a) contracts would total 30 percent or less in each industry.

These approaches, while they have some advantages, and could be used in a highly controllable procurement environment, were rejected for a variety of reasons outlined in the report.

I. INTRODUCTION

Public Laws 99-591 and 99-661 require SBA to determine for Fiscal Years 1984-86 if the summed total of small business set-aside and SBA's 8(a) awards in four selected industry groups exceed 30 percent of the value of overall awards. If so, SBA must propose to adjust the relevant industry size standard to a level that will likely reduce the total of small business set-aside and 8(a) awards to approximately 30 percent. The industries specified by the laws are: Construction (Major Groups 15, 16, and 17 of the Standard Industrial Classification (SIC) System); Architecture (SIC-8712) and Engineering Services (SIC-8711), including Surveying and Mapping Services (SIC-8713); Shipbuilding and Ship Repair (SIC-3731); and Refuse Systems (SIC-4953).

While the laws identify only four industry groups for study and adjustment as necessary, many more than four size standards are affected by the 30 percent guidelines. This stems from SBA's practice of setting size standards by industry as identified with 4-digit standard industrial codes. The laws, moreover, specifically direct SBA to relate industry category to the 4-digit Standard Industrial Classification codes. As a result, in construction alone there are 26 industries with size standards, and each of these industry's size standard would be individually lowered if the 30 percent "threshold" were exceeded. SBA's General Counsel has indicated the laws require that we relate each 4-digit industry to a specific size standard, rather than a major group to a specific standard as is the current practice in construction.

The laws also contain a provision which allows for the segmentation of industries when warranted by special equipment, labor, geographic requirements, or to recognize a new industry. SBA has reviewed the issue of whether to establish size standards for segments of two industries--the dredging component of heavy construction, and the ship repair component of the shipbuilding and ship repair industry. Dredging, under this approach, could have separate size standards for light and heavy equipment projects and also by several different regions of the country. The ship repair size standard would vary based on the city where the contract would be performed. The specific regional and equipment guidelines which are described in this review were suggested in explanatory remarks about the law by former Chairman Parren Mitchell of the House Small Business Committee.*

This review shows SBA's findings of set-aside percentage by industry, a description of methods by which new size standards would be chosen to attempt to fulfill the 30 percent requirement for industries exceeding that level of set-aside and 8(a) awards, and a consideration of the regional situation in the dredging and shipbuilding and ship repair industries.

Future steps to implement the law will include a notice in the Federal Register to propose new size standards in the industries requiring adjustment, and the publication of a final rule to take effect some time after October 1, 1987.

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* Congressional Record, October 15, 1986, page H10140

F. ECONOMIC IMPACT

The following table summarizes the number of firms and their associated sales affected by a changing size status, as well as the projected shift in contract dollars out of the set-aside category.

INDUSTRIES AND FIRMS AFFECTED BY PROPOSED SIZE STANDARDS CHANGES

(B = billions of dollars)

SIC	TITLE	NO. OF FIRMS LOSING SMALL BUSINESS STATUS	FIRMS' INDUSTRY SALES	PROCUREMENT SHIFT
15	Building Const.	12,628	$55.7B	$1.3B
16	Non-Building Const.	3,969	$19.0B	$0.3B
17	Special Trades	31,880	$58.5B	$0.7B
C	Const., SUBTOTAL	48,477	$133.2B	$2.3B
8713	Surveying	1,319	$ 0.6B	negligible
	GRAND TOTAL	49,796	$133.8B	$2.3B

The most direct effect of the law as produced by the proposed size standards is the shift of $2.3 billion per year in Federal contracts from the set-aside to the unrestricted category. This represents the dollar value of contracts in excess of the statutory requirement that no more than 30 percent of total Federal contracts be set aside for small and 8(a) businesses in the specified industries. The $2.3 billion amount is at current levels (FY 1984-86 average) of Federal procurement and may be expected to change in the future according to the dollar value of procurements in the targeted industries.

The calculated impact in Government procurement, $2.3 billion, will be most obvious in construction where $4.5 billion was set aside in FY-1986. Thus there could be a 51 percent decline in construction dollars set-aside for small business under the size standards being recommended.

The impact of the proposed size standards may also be evaluated on an economy wide basis. Approximately 50,000 firms would lose small business status through the imposition of the proposed size standards. These firms account for approximately $133 billion in industry sales. Of course, not all of these firms are in the Federal procurement arena or benefit from one of SBA's other programs employing small business status as eligibility criterion. Thus the loss of small business status will have no effect on some of these 50,000 firms.

V. SEGMENTED SIZE STANDARDS

In addition to the size standards adjustments required in the law, SBA also considered whether to establish separate size standards for segments of the dredging and ship repair industries. Such geographic segmentation is permitted under the law if SBA determines that: 1) the Government typically designates the area where the work is to be performed, 2) Government purchases comprise the major portion of the entire domestic market for the good or service in question and, 3) due to the fixed location of facilities, high mobilization costs, or similar economic factors, it is unreasonable to expect competition from business concerns located outside of the general area where the work would be performed. Segmentation may also be considered given special labor and/or equipment requirements of an industry and to reflect a new industry.

SBA's consideration of segmenting the dredging and ship repair size standards reflects the views of former Chairman Parren Mitchell of the House Small Business Committee as presented in the October 15, 1986, Congressional Record. Chairman Mitchell believed that these three conditions characterize both the ship repair and dredging markets. He also recommended an approach which would set separate size standards in dredging by light and heavy equipment projects and for five regions of the country. In ship repair, he recommended that each port or city with ship repair capacity would have separate size standards for nuclear and nonnuclear work.

The various regions outlined by Chairman Mitchell were discussed in SBA's March 17, 1987, Advance Notice of Proposed Rulemaking as possibilities for a segmented approach to size standards. In that notice, SBA requested information which could establish significant differences among the various regions based on capital equipment, special labor needs or geographic requirements. SBA also sought the public's view as to whether the three requirements for segmentation are present in the two industries.

Concurrently, the SBA solicited similar information for these two industries from the Army Corps of Engineers for dredging and from the Department of Navy for ship repair. This special request was necessary because the Federal Procurement Data Center does not separate its data by either equipment or region. Unfortunately, the Navy has indicated verbally it does not separate its procurement statistics based on whether a ship is nuclear or non-nuclear propelled, although the Navy has not confirmed such point in writing.

The Corps of Engineers submitted comments on the segmentation issues for the dredging industry on June 3, 1987. They concluded that "segmentation of dredging size standards is not appropriate." In their letter, the Corps of Engineers pointed out that the third condition identified above did not prevail for the dredging industry; although, the first and second conditions do. In fact large and small dredging firms transport equipment over long distances (including to different coastal regions) to perform work. The Corps also commented that segmentation by equipment may act to restrict competition in the dredging industries. In addition to these specific comments on the dredging recommendations, the Corps emphasized that the Water Resources Development Act of 1986 will significantly increase the level of dredging work for the industry. Quoting from the Corps' letter:

> "In conclusion, it is our opinion that segmentation of dredging size standards is not approrpiate. Segmentation does not meet the requirements of the National Defense Authorization Act for Fiscal Year 1987 (condition 3) nor does it foster competition within the dredging industry. The potential impact of Public Law 99-662 on the small business dredging community is of concern in this respect. Where strong competition existed between dredging companies due to the limited yearly yardage in the past the industry

is now faced with an abundance of dredging work for some time in the future. As a result, we anticipate that many traditional small dredging companies that operated under the set-aside program will begin to bid on non-set-aside larger dredging jobs thus reducing the number of dredging contractors bidding on set-aside work. This will likely result in less small business competition and fewer jobs set aside since the remaining small contractors may lack adequate sized equipment to perform traditional set-aside work.

Therefore, the Corps recommends that SBA continue to utilize one size standard for dredging which has resulted in an effective set-aside dredging program in the past. We believe this will foster needed competition within the industry to perform dredging work in a timely manner and at reasonable cost to the Government."

Other comments on the proposed dredging segmentation are contained in Appendix II.

SBA recommends not proposing segmented size standards for the dredging industry for several reasons. First, competition for dredging work is not limited to a geographical region of the country. The mobility of dredging equipment allows for coast-wide or broader competition on a contract solicitation. Also, dredging firms have some degree of flexibility in selecting the type of equipment to use on a project. Second, the data needed for analysis to establish segmented size standards are not readily available and collection of these data would likely be an extremely difficult task. Finally, segmented size standards add administrative complexity to the size standard regulations. Not only are more size standards issued, but problems of interpretation may arise due to imperfect regional, equipment, or labor distinctions. Administrative precedent of establishing segmented size standards may easily lead to the demand for segmentation in many other industries; and therefore, additional complexity to the size standard regulations.

Segmented standards for the shipbuilding and ship repair industry have received mixed support. Private shipyards commenting on the proposal are divided. Three shipyards are for segmentation (two large shipyards and one small) and four small shipyards are opposed. Two associations representing shipyards provided comments. The American Waterways Shipyard Conference, representing small and medium size shipyards, is opposed to geographic standards and recommends retaining the current standards. It also raised the issue of size standards for inland waterways. The Shipbuilders Council of America (SCA) took issue with SBA determining the market structure of the ship repair industry, as defined by SIC Code 3731. Although SCA agreed that ship repair met the geographic segmentation criteria, they reserved comment on the proposed geographic segmentation of ship repair work until a proposed rule is published.

SBA formally wrote to the Department of the Navy on October 21, 1986, and March 18, 1987, for comments on the segmentation of the shipbuilding and ship repair industry. To date, the Navy has not provided their comments.

In view of the importance of the Navy's role in the shipbuilding and ship repair industry, SBA defers its recommendation on this issue until the Navy's comments are received and analyzed.

VI. SUMMARY

This report has reviewed the level of set-aside and 8(a) contracts awards in relation to overall Federal contract awards for four industry groups. Twenty-six of the 29 industries within the four industry groupings have set-aside and 8(a) contract awards exceeding 30 percent of overall Federal contract awards during FY 1984-86. In accordance with Public Laws 99-591 and 99-661, revised size standards have been developed that would likely reduce the set-aside and 8(a) contract awards to less than 30 percent of overall awards. An estimated $2.3 billion in contracts would have to be transferred to unrestricted procurements from the set-aside and 8(a) programs to implement the laws. Approximately 50,000 firms would be defined as "other than small business," and thus, lose eligibility for SBA programs.

The laws address two features of the set-aside and 8(a) programs--a cut off point for set-aside awards and the definitions of eligible firms. For the impacted industries, the set-aside levels tend to be relatively high. However, these particular industries are characterized by many opportunities for small businesses to obtain fairly large Federal contracts. Also, these industries offer more opportunities for individuals to start-up businesses due to modest labor and capital requirements. This is not true in all industries selling to the Federal Government. Therefore, there is the question of whether the recommended approach would be appropriate for setting size standards across the board.

As discussed above, the laws address two features of the set-aside and 8(a) programs--the level of set-asides and the definition of eligible small businesses. These features focus policy debate on questions of how much contract funding to devote to support these programs and what size firms will be the potential beneficiaries of the programs.

The laws attempt to answer the question of the level of contract funding by controlling who may participate in the programs. Clearly, there is at least one other policy option--to lower set-asides and 8(a) contracts by setting a cap on a Federal-wide or Agency-wide basis. SBA recommends further Congressional review of Congress' objectives in this area prior to their imposition of the recommended or alternative approaches as a permanent method for setting standards in all industries.

Proposed Rules

Federal Register
Vol. 52, No. 242
Thursday, December 17, 1987

This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

SMALL BUSINESS ADMINISTRATION

13 CFR PART 121

Small Business Size Standards for Construction and Surveying Services Industries and Subcontracting Limitations

AGENCY: Small Business Administration.

ACTION: Proposed rule.

SUMMARY: The Small Business Administration (SBA) is proposing to amend its size standards for the construction industry division (except heavy construction, not elsewhere classified, and dredging), and for the surveying services industry. In addition, subcontracting limitations, requiring that at least 15 percent of the contract labor value for general contractors and 25 percent for special trades must be performed with the winning contractor's work force on set-aside and 8(a) contracts, are being proposed for the construction industries. The proposed size standard revisions are pursuant to identical requirements of Pub. L. 99-591 and Pub. L. 99-661. The issuance of proposed rules to implement the public laws was made known to the public through an "Advance Notice of Proposed Rulemaking" (ANPRM) on March 17, 1987 (52 FR 8261).

Pub. L. 99-591 and 99-661 amend the Small Business Act in several areas. One amendment requires SBA to review four selected industry groups for the Fiscal Years 1984-86 to determine if the total dollar value of small business set-aside and SBA's 8(a) awards in any of these industries exceeds 30 percent of the value of overall Federal procurement awards in the respective industries. If so, the laws require SBA to lower the relevant industry size standard to a level that will likely reduce the total of small business set-aside and 8(a) awards to approximately 30 percent of total Federal procurements. SBA has conducted a review of Federal procurement awards in the following industry groups: Construction, architecture and engineering services (including surveying and mapping), shipbuilding and ship repair, and refuse systems and related services. Based on this review, SBA is proposing an amendment to its size standards in 26 industries. Pub. L. 99-591 and 99-661 also grant SBA the authority to establish segmented size standards to reflect special equipment, labor or geographic requirements. SBA is not proposing segmented size standards for the dredging and shipbuilding and ship repair industries that were presented for consideration in the March 17, 1987, ANPRM.

The legislation requiring the review of size standards also required that recipients of small business set-asides and 8(a) contracts agree to perform with its own employees: 50 percent of the cost of performance (excluding materials) of supply contracts (except for regular dealers); 50 percent of the cost of performance of service contracts; and, a similar requirement for construction, the proportion to be established by regulation. SBA proposes to amend its size regulation to implement these requirements, and in the case of construction is proposing that figures established in the SBA's regulation (13 CFR Part 124) for 8(a) firms be used as the reference point. This regulation states that "at least 15 percent of the contract labor value for general contractors and 25 percent of special trades, must be performed with the contractor's own work force." SBA encourages commentors to review closely these subcontracting limitations for construction as it wishes to establish percentages reflecting traditional industry practices in construction.

SBA is publishing this regulation for public comment as a step in the implementation of Pub. L. 99-591 and 99-661, which amended the Small Business Act to require adjustment of size standards to control the levels of small business set-aside and 8(a) awards in each SIC.

In addition to soliciting comments on the provisions of this Notice of Proposed Rulemaking, SBA is interested in receiving comments on any other methods for achieving the stated purposes of controlling the level of set-asides in Federal procurements. Commentors should address the elements of feasibility and impact relative to the existing method, when providing alternative approaches to the issue.

DATE: Comments to be submitted on or before February 16, 1988.

ADDRESSES: Address comments to: Monika Edwards Harrison, Chairperson, Size Policy Board, U.S. Small Business Administration, 1441 'L' Street, NW.—Room 600, Washington, DC 20416.

FOR FURTHER INFORMATION CONTACT: Gene VanArsdale, (202) 653-6368.

SUPPLEMENTARY INFORMATION: Pub. L. 99-591 (An Act making continuing appropriations for Fiscal Year 1987) and an identical provision of Pub. L. 99-661 (National Defense Authorization Act for Fiscal Year 1987) require the Small Business Administration to complete a review of its size standards in four industry groups: Construction (all Standard Industrial Classification (SIC) codes in Major Groups 15, 16, and 17 of the SIC system); Architecture and Engineering Services, including Surveying and Mapping Services (SIC Codes 8711, 8712, and 8713, respectively); Shipbuilding and Ship Repair (SIC Code 3731); and Refuse System and Related Services (SIC Code 4953).

It should be noted that the construction and architectural and engineering services industry groups include a number of 4-digit SIC industries with separate size standards. Construction includes nine industries in general construction and 17 special trade industries. Architectural and engineering services have three industries with size standards. In addition, the two industry groups have three size standards based on components of two 4-digit SIC industries. Consequently, 31 industries covering 34 size standards were reviewed.

This proposal describes the data sources and methodologies for identifying the industries in the four major groups in which the total of set-aside and 8(a) contract dollars expended between FY 1984 and 1986 exceeded 30 percent of Federal procurement awards and for developing lower size standards that will likely reduce the total of small business set-aside and 8(a) awards to approximately 30 percent for industries above that level. Proposed size standards are listed at the end of the proposed rule for those industries requiring adjustment. The proposal also describes a proposal for subcontracting limitations at specific percentages for the construction industry. This is followed by a discussion of the reasons for not proposing segmented size standards for the dredging and shipbuilding and ship repair industries.

Percent of Set-Asides by Industry

Table 1 presents the average FY 1984–86 total of set-aside and 8(a) awards as a percentage of all Federal procurement dollars for each Standard Industrial Classification (SIC) industry designated in the law for review. Set-aside contracts plus 8(a) contracts exceed 30 percent of Federal procurements for all construction industries, except SIC Code 1629 (Heavy Construction, Not Elsewhere Classified, and its dredging component which has a distinct size standard), and for the surveying services industry, SIC Code 8713 (formerly a part of SIC–8911).

Table 1.—Procurement Data Relating to Industries Covered by Pub. L. 99-591[1]

[M=millions of dollars]

SIC	Present size standard	Set-aside plus 8(a) procurement dollars	Total federal procurement dollars	Percent set-aside and 8 (a) awards	Percent in excess of 30 percent	Dollars targeted to be shifted to unrestricted category by lowering the size standard
Construction: Building Construction						
1521*	$17.0M	$142.5M	$314.3M	45.3	15.3	$48.1M
1522*	17.0M	127.3M	326.5M	39.0	9.0	29.4M
1531*	17.0M	8.0M	17.6M	45.7	15.7	2.7M
1541*	17.0M	586.5M	1,073.9M	54.6	24.6	264.2M
1542*	17.0M	1,854.9M	2,898.1M	64.0	34.0	985.4M
Construction Other Than Building						
1611*	$17.0M	$390.7M	$732.6M	53.3	23.3	$170.7M
1622*	17.0M	65.1M	123.6M	52.6	22.6	28.0M
1623*	17.0M	155.0M	216.3M	71.7	41.7	90.2M
1629 (Less Dredging)	17.0M	237.9M	1,142.9M	20.8	0.0	0.0M
1629 (Dredging Component)	9.5M	50.8M	306.7M	16.6	0.0	0.0M
Special Trades:						
1711*	$7.0M	$390.4M	$558.2M	69.9	39.9	$222.7M
1721*	7.0M	96.0M	107.1M	89.6	59.6	63.9M
1731*	7.0M	262.3M	419.5M	62.5	32.5	136.3M
1741*	7.0M	8.1M	11.7M	68.9	38.9	4.6M
1742*	7.0M	15.5M	23.0M	67.7	37.7	8.7M
1743*	7.0M	1.2M	1.5M	78.7	48.7	0.7M
1751*	7.0M	13.5M	14.7M	91.7	61.7	9.1M
1752*	7.0M	8.7M	9.9M	88.2	58.2	5.8M
1761*	7.0M	126.1M	141.2M	89.3	59.3	83.7M
1771*	7.0M	43.6M	47.6M	91.5	61.5	29.3M
1781*	7.0M	3.9M	7.1M	55.4	25.4	1.8M
1791*	7.0M	10.0M	21.9M	45.9	15.9	3.5M
1793*	7.0M	5.2M	5.8M	90.0	60.0	3.5M
1794*	7.0M	83.9M	111.3M	84.4	54.4	60.5M
1795*	7.0M	7.6M	9.5M	80.0	50.0	4.8M
1796*	7.0M	9.2M	17.5M	52.6	22.6	4.0M
1799*	7.0M	66.1M	127.9M	51.7	21.7	27.8M
Shipbuilding and Ship Repair						
3731	1,000E	$424.0M	$5,528.9M	7.7	0.0	$0.0M
Refuse Systems						
4953	$6.0M	$16.2M	$72.4M	22.4	0.0	$0.0M
Engineering, Architectural and Surveying						
8711(A)	13.5M	143.4M	1,011.6M	14.2	0.0	0.0M
8711(B)	9.0M	32.0M	446.0M	7.2	0.0	0.0M
8711**(C)						0.0M
8712	2.5M	108.7M	434.7M	25.0	0.0	0.0M
8713*	2.5M	17.4M	23.4M	74.0	44.0	10.3M

*=Size Standard Change Required By Law.

8711(A)=Engineering Services for Military and Aerospace Equipment and Military Weapons.

8711(B) = Engineering Services for Marine Engineering and Naval Architecture Services.
8711(C) = Engineering Services Unrelated to Military or Aerospace Equipment or Marine and Naval Architecture Services.
8712 = Architectural Services (Other Than Naval).
8713 = Surveying Services.
** = SBA is unable to separate activities related to 8711 (C) from 8712 for statistical purposes related to the implementation of the 30 percent rule. Until better data are received which is unique to either activity, SBA will retain the present size standards in these activities.
[1] Procurement Data are shown as 1984–86 average annual dollars.

The variation by SIC for those industries exceeding 30 percent was from 43 to 71 percent of all Federal purchases for general construction industries and for special trades industries it was from 45 to 94 percent. Set-aside and 8(a) contracts for Shipbuilding and Ship Repair were substantially below 30 percent. Similarly, set-asides for Refuse Systems, SIC–4953, at 23 percent, were well below the 30 percent threshold. For SIC–8711 to 8713, Engineering Architecture and Surveying (formerly grouped together under SIC–8911), the set-asides plus 8(a) share of the three industries averaged 16 percent of all Federal procurements. However, SIC–8713, Surveying Services, had a set-aside and 8(a) share of 74 percent.

The last two columns of Table 1 provide information relating to the targets which the statutes require SBA to consider when lowering its size standards. The goal in revising the size standard of SIC–1521 (Single-Family Housing Construction), for example, is to reduce the present size standard of $17 million (first column) to a level that is likely to reduce set-asides to 30 percent. This would be achieved by shifting 15 percent (fifth column) of Federal revenues in the industry from the set-aside to unrestricted category. Based on average contract data over the 1984–86 period, $48 million dollars in Federal contracts (sixth column) would have to move from the set-aside to unrestricted category for this industry to meet the 30 percent level. The proposed size standard for SIC–1521 is expected to be effective in reducing set-asides by $48 million. Similar projections are provided in Table 1 for every industry affected by the law.

Data

The laws direct the SBA to adjust size standards based on Federal procurement patterns for any 4-digit SIC code industry classified in the four major industry groups. Data for making such a determination are gathered by the Federal Procurement Data Center (FPDC) of the General Services Administration. No other agency of Government gathers aggregated Federal procurement data. Table 1 was developed from the FPDC data.

To understand the strengths and weaknesses of data gathered by the FPDC, it is useful to understand how a size standard is utilized in the process of setting aside a contract for small business. To determine the appropriate size standard for a contract, the Federal contracting officer must determine the industry most closely associated with the contract in question. A firm must then meet the size standard test for eligibility to bid on the contract. It is important to note that the firm may only be peripherally involved in the industry associated with the size standard. Firms often produce goods and/or services associated with more than one industry. The proper category to calculate an industry's percentage of set-asides to total Federal procurements is the industry or SIC code associated with the contract award.

To date, contract data have not been gathered by the FPDC on an industry basis. The only industry data which SBA was able to obtain from the FPDC is the primary SIC code of the business establishment receiving the contract, not the SIC code identified with the contract itself. Thus only an approximation is available of the extent of 8(a) and set-asides purchases for the individual industries based on contract information. The data, nevertheless, are considered reasonably close to the results which would have been obtained had SBA been able to gather the data in the form specified in the law. For the industries studied, and especially for the smaller size firms of the industry, the SIC classification of the firm is most likely the SIC classification of the procurement. Beginning in 1989, FPDC will be collecting data on the SIC code of awarded Federal contracts, as requested by SBA.

Adjusting Industry Size Standards

The table at the end of this proposed rule shows the proposed size standards for those industries identified in Table 1 which exceeded the 30 percent level. A methodology for adjusting size standards was developed by considering how set-aside contracts are selected. The method assumes that by eliminating from eligibility the larger small firms winning 8(a) or set-aside contracts it will be more difficult to set aside contracts. Consequently, the proportion of set-asides as a percent of total Federal procurement dollars would become lower.

A size standard is calculated which will eliminate from eligibility those larger small firms which have cumulatively been awarded set-aside and/or 8(a) contracts in excess of the 30 percent level. Table 2 illustrates this approach. All firms which received a set-aside or 8(a) contract in the industry are ranked by firm size (receipts from all sources). In the example, the largest small firm in the distribution had $6.9 million in sales with $4 million of its sales from set-aside and or 8(a) contracts. In order to achieve the desired 30 percent, $20 million in set-aside and/or 8(a) contracts would have to become unrestricted contracts. In this example, this is achieved by lowering the size standard to $5.8 million. This eliminates the largest small firms which have cumulatively been awarded set-aside and/or 8(a) contracts totaling $20 million.

TABLE 2.—HYPOTHETICAL EXAMPLE

Firms receiving set-aside and/or 8(a) contracts ranked by size of firm (M = millions of dollars)

Firm	Firm size	Total amount of the receipts awarded as firm's set-aside and/or 8(a) contracts over the year
A	$6.9M	[1] $4M
B	6.7M	[1] 1M
C	6.5M	[1] 5M
D	6.3M	[1] 3M
E	6.1M	[1] 3M
F	5.9M	[1] 4M
G	5.7M	[1] 3M

[1] Set the size standard to eliminate firms generating the targeted level of $20.0M in set-aside or 8(a) contracts by lowering the size standard from $7.0 to $5.8 million.

In order to calculate size standards using this method, SBA obtained microdata information from SBA's United States Establishment and Enterprise data base in which each contract awarded was identified with the size of firm winning the contract. SBA ranked firms active in the set-aside market by size of firm and these firms were cross-tabulated with awarded set-aside and 8(a) contracts to develop tables, such as Table 2, for each industry.

In the past SBA has also established a separate size standard for the activity of base housing maintenance. This size standard was utilized if a contract involved the use of special trade contractors in different industries (plumbing, painting, plastering, carpentering, etc.). The size standard was $7 million (the same as all industries in special trades at that time) and it was utilized when three or more special trade activities were incorporated in the same contract.

The size standard for any contract composed of three or more special trade activities (formerly defined as a base housing maintenance) will now be the size standard of the special trade accounting for the greatest percentage of the total contract value. This is similar to the rule established for determining the size standard for other multiple-item contracts.

Subcontracting Limitations

The Advanced Notice of Proposed Rulemaking published March 17, 1987, stated that "SBA intends to use the statutory figure of 50 percent as its reference point for all service and supply (including manufacturing) industries, and the figures established in SBA's regulation (13 CFR Part 124) for 8(a) firms as the reference point for construction. This advance notice stipulated that "at least 15 percent of the contract labor value for general contractors and 25 percent of special trades must be performed with the contractor's own work force." There was in the public response to the March 17, 1987, notice, some favorable response to the figures of 25 percent and 15 percent as required levels for a contractors's own work force in special trades and general contracting, and they are retained in this proposed rule. In addition, public comment provided no special data to challenge the 50 percent figure for either supply or service contracts, although several submissions contained general discussion, pro or con, on the subcontracting limitations.

SBA is authorized to deviate from the 50 percent requirement for supply and service contracts for any industry where it is necessary to reflect conventional industry practices among business concerns that are below the industry category. Therefore, SBA is soliciting further comments concerning specific industry practices that would support any deviation from this proposal. In proposing the 15 and 25 percent subcontracting requirements for general contractors and special trades respectively, SBA is attempting to approximate traditional industry practices in construction. Any commentors who are able to provide information on traditional industry practices in the construction industries are encouraged to comment to the SBA.

Geographic Size Standards

In the Advance Notice of Proposed Rulemaking published on March 17, 1987, (52 FR 8261), SBA solicited comments on the subject of establishing separate geographic size standards for segments of the dredging and ship repair industries as authorized by the special segmentation provisions contained in Pub. L. 99-591 and Pub. L. 99-661. These segmented standards were:

SIC—3731 Shipbuilding and Ship Repair.

(At present this industry has a size standard of 1,000 employees).

(1) Nuclear ship repair and shipbuilding
(2) Shipbuilding (nonnuclear)
(3) Nonnuclear ship repair at:
  (a) Puget Sound/Portland
  (b) San Francisco
  (c) Los Angeles/Long Beach
  (d) San Diego
  (e) New England
  (f) New York/Philadelphia/New Jersey
  (g) Norfolk/Baltimore
  (h) Charleston
  (i) Jacksonville, Florida
  (j) Gulf Coast

SIC—1629 Heavy Construction, Not Elsewhere Classified—dredging component

(At present this industry has a size standard of $9.5 million in gross annual receipts).

(1) *Heavy Equipment/Dredging*
  (a) Northeast
  (b) Southeast
  (c) Gulf Coast
  (d) West Coast
  (e) Great Lakes
(2) *Light Equipment/Dredging*
  (a) Northeast
  (b) Southeast
  (c) Gulf Coast
  (d) West Coast
  (e) Great Lakes

SBA requested information which could establish significant differences within an industry based on capital equipment or special labor needs, or geographic requirements. SBA also sought the public's view as to whether the three statutory prerequisites which must be present before geographic segmentation of size standards may be established are present in the two industries. These prerequisites are: (1) The Government typically designates the area where work for such contracts is to be performed, (2) Government purchases comprise the major portion of the entire domestic market for such goods or services, and (3) due to the fixed location of facilities, high mobilization costs, or similar comments on the March 17, 1987, Federal Register AMPRM notice were received from private firms, industry associations, and Government agencies (e.g., Corps of Engineers). A majority of those commenting on the notice did not support segmented size standards for dredging. The comments included one dredging firm and one association that favored the concept of a regional standard, while four firms and two associations were opposed. Comments on segmented size standards for shipbuilding and ship repair were received as follows: Two firms and one asssociation favored the concept, four firms and one association were opposed, and one association reserved comment on this issue until a proposed rule was issued.

The respondents raised several concerns regarding the proposed segmentation. Respondents in both industries opposed the idea of segmented size standards based on legal considerations. In dredging, respondents argued that dredges are mobile, and therefore, the statutory condition precluding competition from outside the regions listed above is not met. In ship repair, respondents argued that firms could change their area of operation by either leasing space in another shipyard or by moving operations. Moreover, ships themselves are mobile allowing for contracts on a national or coast-wide basis. As a result, firms often compete with firms outside their regions.

In response to these objections, SBA also sought out the opinions of the Army Corps of Engineers for the dredging industry and the Navy for the ship repair industry. The Corps stated that the third requirement for segmentation was not present and opposed the proposal. The Navy does not support either geographic or equipment based segmentation of the ship repair size standard and prefers to continue following the current policies and procedures for ship repair set-asides. SBA concludes that neither the dredging nor the ship repair industry meet the statutory requirement that it is unlikely to expect competition from business concerns located outside of the general areas where such concerns are located. Accordingly, SBA is not proposing segmented size standards for these two industries.

Compliance With Regulatory Flexibility Act and Executive Order 12291

This proposed rule if made final would have a significant effect on a

substantial number of small firms as described in the Regulatory Flexibility Act. It would also constitute a major rule under E.O. 12291. The preceding information described the basis for this proposed rule, why it is being made, its objectives, and how it is to be implemented. The legal bases for this proposed rule are section 3 and 5(b) of the Small Business Act, 15 U.S.C. 632 and 634(b) and section 921 of Pub. L. 99-591. Below is an economic analysis of this proposed rule. It assesses the impact on small business eligibility (demographic impact) for SBA's programs, and the dollar impact on Federal procurements and the affected firms.

This rule would affect businesses within the construction and surveying industries in terms of their eligibility for SBA programs. Focusing on construction, as a proportion of total economic activity, Federal procurement represents only about 3 percent of all construction; nonetheless, it has significant implications for a certain segment of construction firms.

Because the law mandates reductions in the amount of set-aside contracting by changing the size standards, a number of firms will lose small business status, and consequently, lose eligibility for SBA programs. Also, some firms will not be successful in obtaining future Federal contracts as a result of a shift in contracts from the set-aside to the unrestricted method of Federal contracting as they had been in the past.

The proposed size standards have a distributional economic impact on the firms within an industry. The distributional economic impact for those firms losing small business eligibility may be assessed in terms of the demographic and dollar impacts. Those impacts are analyzed below.

The *demographic impact* is the number of firms which would be affected by the proposed rule. The broadest impact, and least consequential, simply quantifies the number of firms no longer defined as small business. SBA estimates that about 50,000 firms would lose small business status, or about 10 percent of a total of 500,000 construction and surveying firms listed in SBA's Small Business Data Base (SBDB). While this change can be disaggregated for each of the 26 industries affected, for convenience these results are presented for each major group in Table 3.

While these firms would lose small business status, the actual number of firms directly impacted would be less than 2 percent of the 500,000 firms because not all of these firms participate in Federal procurement or SBA's financial assistance programs. This smaller impact is estimated from an analysis of Federal procurement discussed below.

TABLE 3.—INDUSTRIES AND FIRMS AFFECTED BY PROPOSED SIZE STANDARDS

[B=billions of dollars]

Sic (1)	Title (2)	Number to firms (3)	No. of firms losing small business status (4)	Industry sales (5)
15	Building Const	187,383	12,628	$55.7B
16	Non-Building Const	22,792	3,969	19.0B
17	Special Trades	293,002	31,880	58.5B
C	Const. Subtotal	503,177	48,477	$133.2B
6713	Surveying Services	6,226	1,319	0.6B
	Total—All Industries	509,403	49,796	$133.8B

Source: Small Business Data Base, USEEM, 1984.

To obtain a more accurate picture of the direct impact, SBA's two principal programs were examined for the demographic effect. First, in the procurement assistance program, the PASS[1] lists about 26,000 construction firms and 1,200 surveying firms. This is about 5 and one-half percent of the 500,000 listed in the Small Business Data Base. While not all firms interested in Federal procurement are listed in PASS, those firms listed are more likely to be directly affected by a size standard change than those in the industry in general.

Due to the proposed size standards, it is estimated that based on the PASS data, approximately 8,000 construction and surveying firms would lose small business status. This impact is summarized in the following table.

TABLE 4.—NUMBER OF FIRMS IN PASS LOSING SIZE STATUS

Sic	Description	Number in PASS	Losing small business status
15	Gen. Construction	1,610	276
16	Gen. Constr.-Non Building	6,403	1,519
17	Special Trades	17,829	5,465
C	Construction Subtotal	25,842	7,260

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[1] PASS (Procurement Automated Source System) is a computerized list of small businesses interested in Federal contracting and their capabilities. Any firm can be listed by filling out a simple form. Inclusion in PASS is not mandatory and is intended to help procuring agencies in identifying small businesses interested in doing business with the Federal Government.

TABLE 4.—NUMBER OF FIRMS IN PASS LOSING SIZE STATUS

Sic	Description	Number in PASS	Losing small business status
8713	Surveying Services	1,219	850
	Total—All Industries	27,061	8,110

Source: PASS, SBA Office of Procurement Assistance, data as of June 26, 1987.

The number of firms potentially impacted by the proposed rule is more likely to be closer to 8,000 firms or 1.6 percent of 500,000 firms shown in Table 3.

The number of guaranteed loans to firms made ineligible by the proposed size standards is small. Based on an analysis of SBA's major loan program, the Business Loans Program, an average of 901 loans per year to construction firms were made during FY 1984–86. No information is available as to the size of firms receiving these loans other than qualifying as small under the appropriate size standard. With a decline in eligibility of construction firms, either fewer loans would be made or the loans that would have been made to the newly ineligible firms would go to the remaining firms. If fewer loans were actually made, the impact could be on the same order of magnitude as firms losing eligibility as is shown in Table 3, that is, about a 10 percent decline based on the number of firms generally losing small business status. This would be a decrease of about 90 loans to construction firms per year.

The *dollar impact* of the proposed size standards can be broken out into three segments: General industry effect, procurement program effect, and financial program effect. First, the general industry effect is total sales (commercial and Federal) associated with the 50,000 firms losing small business status. As shown in Table 3, these firms generated $133.8 billion in industry sales. The proposed size standards will impact the sales generated by this group of firms. However, the impact is not on total industry sales, but those sales resulting from set-asides. This narrower impact has been analyzed as the procurement program effect.

The procurement program effect is estimated to equal $2.3 billion based on average 1984–86 levels. This is the value of Federal contracts which must be shifted away from small business set-asides to unrestricted contracts to meet the requirements of Pub. L. 99–591 that no more than 30 percent of total Federal contracts may be awarded as set-asides or 8(a) contracts in the specified industries. Table 5 shows this effect by major industry group.

TABLE 5.—SHIFT IN PROCUREMENT DOLLARS UNDER PROPOSED SIZE STANDARD

[B = billions of dollars]

Sic	Description	Procurement shift
15	Gen. Construction	$1.3B
16	Gen. Constr.-Non Building.	$0.3B
17	Special Trades	$0.7B
C	Construction Subtotal	$2.3B
8713	Surveying Services	Negligible
	Total—All Industries	$2.3B

Source: Special Tabulation of FPDC and SBDB/USEEM, 1984 + 1986 average.

In 1986 Federal procurements set aside for small business in construction totaled $4.5 billion. The shift of $2.3 billion away from set-asides would therefore bring about a 51 percent decline in construction dollars set aside for small business. This reduction would be incurred by an estimated 1,818 construction firms and 40 surveying firms according to a special tabulation of Federal Procurement Data Center and SBDB statistics for 1986. In 1986, 6,855 construction firms received set-aside contracts.

The estimated impact produced by implementing the law, $2.3 billion less in set-aside contracts, rests on the critical assumption that lowering the specified size standards will cause contracting agencies to replace that amount of set-asides with unrestricted contracts. Contracting agencies will be under no direct orders to reduce set-asides. It remains to be seen whether the indirect course of lowering size standards will have the required effect of reducing set-asides by more or less than $2.3 billion. If set-asides remain above 30 percent of total Federal procurements, then further adjustments to size standards will be considered.

Third, in SBA's major financial assistance program, the Business Loans Program, the dollar value of guaranteed loans which would have been received by those firms made ineligible by the proposed size standards reductions is estimated at about $14.6 million or about 0.5 percent of $3 billion of loans. This is derived from the estimated loss of 90 loans (see above) multiplied by the $162,000 average SBA loan amount for construction during 1984. Whether there actually will be a decrease in SBA's lending of this amount is uncertain, as this amount may simply be displaced to smaller firms which are still eligible. What could occur in some cases is a transfer rather than a net change in loans.

The economic analysis provided above focused on the distributional impacts of revised size standards. A broader economic analysis would also consider allocative impacts. These impacts are not examined, since they are expected to be minimal in the aggregate. For example, the allocation of resources between private and public purposes will not be affected. The overall level of Government spending for procurement will not change as a result of the size standards. Some arguments can be made that an efficiency gain on Federal procurements would occur as a result of lower size standards. These arguments would rest on the assumption that firms receiving unrestricted Federal procurements can perform at lower costs than small firms awarded set-aside procurements. These efficiency gains, if any, would be expected to be minimal for two reasons. First, competition between two or more small firms must exist before a contract may be set aside for small business. Second, set-asides are expected to be awarded at reasonable prices. Otherwise, the procuring agencies will issue unrestricted procurements if competition and reasonable pricing do not exist on the proposed set-asides. Thus the benefits in the form of cost savings to the Government are expected to be insignificant and were not quantitatively analyzed. Rather, the more relevant and more important distributional impacts are the focus of the economic analysis.

In addition, the proposed size standards are not expected to have an appreciable effect on the prices of goods and services, profit, growth, innovation, mergers, or foreign trade. The aggregated impact including firm failures, employment losses, community impact, and the effect on industry or the economy is not expected to be significant. The likelihood of firm failures and associated unemployment is very small if the proposed rule goes into effect, although there will likely be some individual firms which will lose Government contracts as a result of their loss of eligibility for set-aside contracts. However, as SBA states in its size standards regulations, 13 CFR 121.1(e), firms should not regard SBA's assistance "as permanent nor as the primary source of a firm's sales * * * and should plan for the day when they can compete without assistance."

SBA certifies that this proposed regulation contains no changed or special reporting or recordkeeping requirements which are subject to the Paperwork Reduction Act.

Lists of Subjects in 13 CFR Part 121

Government procurement, Government property, Grant programs-business, Loans programs-business, Small business.

Accordingly, the SBA proposes to amend Part 121 of 13 CFR as follows:

PART 121—[AMENDED]

1. The authority citation for Part 121 of 13 CFR would be revised to read as follows:

Authority: Pub. L. 99-591 and Pub. L. 99-661, Secs 3(a) and 5(b)(6) of the Small Business Act 15 U.S.C. 632(a) and 634(b)(6).

§ 121.2 [Amended]

2. In § 121.2(c)(2), Division C—Construction would be revised as follows:

Note: Upon adoption the "PROPOSED STANDARD" caption contained in Division C and Division I will be changed to read "FINAL RULE" to conform to the CFR format.

DIVISION C.—CONSTRUCTION

	Description—(N.E.C. = Not Elsewhere Classified)	Size standards in millions of dollars—Proposed Standard
'ajor Group 15—Building Construction—General Contractors and Operative Builders		
1521	General Contractors—Single-Family Houses	$2.0M
1522	General Contractors—Residential Buildings, Other than Single-Family	$9.75M
1531	Operative Builders	$1.25M
1541	General Contractors—Industrial Buildings and Warehouses	$5.25M
1542	General Contractors—Nonresidential Buildings, Other than Industrial Buildings and Warehouses	$3.50M
Major Group 16—Construction Other Than Building Construction—General Contractors		
1611	Highway and Street Construction	$4.00M
1622	Bridge, Tunnel and Elevated Highway Construction	$1.75M
1623	Water, Sewer, and Pipe Lines, Communication and Power Line Construction	$1.25M
1629	Heavy Construction, Except Dredging, N.E.C.	$17.0M
1629	Dredging and Surface Cleanup Activities	$9.5M
Major Group 17—Construction—Special Trade Contractors		
1711	Plumbing, Heating (Except Electric), and Air Conditioning	$1.25M
1721	Painting, Paper Hanging, and Decorating	$.50M,
1731	Electrical Work	$1.50M
1741	Masonry, Stone Setting, and Other Stonework	$1.50M
1742	Plastering, Drywall, Acoustical, and Insulation Work	$.25M
1743	Terrazzo, Title, Marble, and Mosaic Work	$1.25M
1751	Carpentenng	$.75M
1752	Floor Laying and Other Floor Work, N.E.C.	$.75M
1761	Roofing and Sheet Metal Work	$1.00M
1771	Concrete Work	$.50M
1781	Water Well Drilling	$.75M
1791	Structural Steel Erection	$4.50M
1793	Glass and Glazing Work	$1.00M
1794	Excavating and Foundation Work	$.50M
1795	Wrecking and Demolition Work	$3.75M
1796	Installation or Erection of Building Equipment, N.E.C.	$2.75M
1799	Special Trade Contractors, N.E.C.	$2.50M
—	Base Housing Maintenance	Deleted

3. In § 121.2(c)(2), Division I—Services is proposed to be amended by adding SIC–8713 to read as follows:

DIVISION I.—SERVICES

Major Group 87—Miscellaneous Services		
8713	Surveying Services	$.25M

* * * * *

4. Section 121.5 is proposed to be amended by adding a new paragraph (h):

§ 121.5 Small business for Government procurement.

(h) A concern may not be awarded a contract for a Government procurement as a small business concern unless the concern agrees that:

(1) In the case of a contract for services (except construction), the concern will perform at least 50 percent of the cost of the contract with its own employees;

(2) In the case of a contract for supplies or products (other than procurement from a regular dealer in such supplies or products), the concern will perform at least 50 percent of the cost of manufacturing the supplies or products (not including the cost of materials):

(3) In the case of a contract for general construction, the concern will perform at least 15 percent of the cost of the contract with its own employees (not including the cost of materials): and

(4) In the case of a contract for construction by special trade contractors, the concern will perform at least 25 percent of the cost of the contract with its own employees (not including the cost of materials).

Dated: December 11, 1987.

James Abdnor,

Administrator, U.S. Small Business Administration.

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